99/32

E.F. HUTTON MAIL AND WIRE FRAUD CASE

HEARINGS

BEFORE THE

SUBCOMMITTEE ON CRIME

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

ON

E.F. HUTTON MAIL AND WIRE FRAUD CASE

JUNE 19, JULY 19, AND AUGUST 1, 1985

Serial No. 32

Part 1

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E.F. HUTTON MAIL AND WIRE FRAUD CASE

WEDNESDAY, JUNE 19, 1985

House of Representatives,
Subcommittee on Crime,
Committee on the Judiciary,
Washington, DC.

The subcommittee met, at 10:10 a.m., in room 2237, Rayburn House Office Building, Hon. William J. Hughes (chairman of the subcommittee) presiding.

Present: Representatives Hughes, McCollum, Morrison, Shaw, Feighan, Lungren, Mazzoli, Staggers, and Smith.

Staff present: Hayden W. Gregory, counsel; Virginia E. Sloan, assistant counsel; Theresa Bourgeois, staff assistant, Eric E. Sterling, assistant counsel; Fred W. Stuckwisch, GAO consultant; Charlene Vanlier Heydinger, associate counsel; Linda C. Hall, clerk; Susan Minato, intern.

Mr. Hughes. The Subcommittee on Crime will come to order.

The Chair has received a request to cover this hearing in whole or in part by television broadcast, radio broadcast, still photography, and by other similar methods. In accordance with committee rule 5(a) permission will be granted unless there is objection. Is there objection?

[No response.]

Hereupon coverage is permitted.

Today marks the first in a series of hearings the Subcommittee on Crime will hold on the subject of white-collar crime. The subcommittee, in its oversight capacity, will explore many different issues, but two predominate.

First, we will review the prosecution of white-collar crime cases by the U.S. Department of Justice.

Second, we will attempt to identify and examine practices and conditions in the corporate world which may be encouraging officers and employees to cross the line between aggressive but legitimate business practices and criminal activities.

The subcommittee intends to hear from a variety of witnesses in these hearings, and to use as examples for our investigation several different white-collar crime cases that have recently been investigated by the Department of Justice.

Today, in the first of these hearings, the subcommittee will explore the case of the *United States* v. *E.F. Hutton*. The E.F. Hutton Co. recently pleaded guilty to 2,000 counts of mail and wire fraud in the middle district of Pennsylvania. The basis of these charges was that Hutton deliberately and illegally overdrafted its depository accounts with a large number of banks. It drew out of these banks enormous amounts of money that had no relation to the amounts of deposits in the accounts.

Hutton also pleaded guilty to creating a series of chains of branch and regional banks in order to increase the time it would take to clear checks, and thus generate and take advantage of the flow.

The effect, in both instances, was to provide Hutton with interest-free loans without the knowledge of the banks. Hutton was sentenced to pay a fine of $2 million to reimburse the Government some $750,000 for investigative costs, and to pay restitution to all the banks victimized by its illegal behavior.

In a companion civil case, Hutton was enjoined from continuing a number of other business practices and activities.

No individuals were prosecuted in the case, in part because the Justice Department concluded that none of those responsible for the criminal acts were members of senior management of the company.

There has been a great deal of public outcry over the disposition of the charges against Hutton. Many have criticized the Justice Department for not proceeding against individuals, and for agreeing to criminal sanctions that appear lenient.

I, for one, have not taken a position on whether the Department's handling of the case was proper or improper. One of the purposes of these hearings is to review just that issue.

I do note, however, that a similar pattern has emerged in several of the cases the subcommittee will investigate. For example, in two Defense procurement fraud cases involving General Electric and the Sperry Corp., and in the Bank of Boston money laundering case, no individuals were charged, and the sentences imposed on the corporations were considered by a lot of people to be very lenient.

There is no doubt that in white-collar crime cases where only an individual can be charged, for instance in the prosecution of Paul Thayer and Jake Butcher, the sentences have been substantial. We must determine, however, whether in cases where there is a possibility of prosecuting both the corporation and its officers and employees the Justice Department is justifiably exercising its discretion to proceed solely against the corporations.

And I just want to say parenthetically that I served for about 10 years as a prosecutor, and there are situations where the prosecuting attorney has to have that discretion if cases so warrant. So I am mindful of the reasons the Justice Department has advanced for its handling of the Hutton case.

Once that decision has been made, that is to prosecute solely against the corporation in this instance, we must also determine whether the sentences agreed to by the Justice Department in a plea bargain are substantial enough to reflect the seriousness of the crime, and to deter others from committing such offenses.

The subcommittee initially scheduled this hearing for June 5, and invited both the Department of Justice and Hutton to testify. Unfortunately because of important Democratic Caucus Republic conference meetings, and other scheduling conflicts, the hearing had to be postponed. The Department was ready and willing to testify, and made its prepared statement available to the subcommittee.

Hutton, on the other hand, declined the subcommittee's invitation. It did so on the grounds that former Attorney General Griffin Bell has been retained by Hutton to investigate how the illegalities took place, and who was responsible, and to recommend any needed changes in the system, and discipline those responsible.

We were first told that this investigation might take 2 to 3 months, and that Hutton officials would not be prepared to testify before then. This response was, I think understandably, unacceptable to the subcommittee. This subcommittee then issued a second invitation to Hutton to testify at today's hearing. It specified that it wanted to hear testimony from four individuals: Robert Fomon, chairman of the Board of E.F. Hutton Group; Thomas Lynch, president of the group and chief financial officer during the time the illegalities occurred; Michael Castellano, comptroller; and Thomas Morley, senior vice president and money mobilizer for the company.

Hutton's response again was unacceptable to the subcommittee. This time we were told that Griffin Bell's report might be ready at the end of June. By then Hutton would be prepared to provide one or perhaps more unspecified witnesses of the same corporate rank as those requested. I note that in Mr. Fomon's statement for today's hearing that it is now predicated that Mr. Bell's report will not be ready until Labor Day.

The subcommittee on crime is charged with a specific responsibility by the Congress and by the public: to conduct oversight investigations of this country's criminal laws, compliance with them by our citizens, and prosecution of them by law enforcement agencies. Griffin Bell's investigation is no doubt important to Hutton, and it may be of some relevance to the investigation we are conducting, and we look forward to receiving any report by General Bell.

However, this subcommittee has undertaken to conduct its own independent investigation of what happened at E.F. Hutton, and of the Justice Department's handling of that case. We cannot let the scope, substance, or timetable of the subcommittee be dictated by the needs or desires of witnesses.

To our regret, therefore, the subcommittee chose to issue subpoenas for the testimony of Mr. Fomon, Mr. Lynch, Mr. Castellano, Mr. Morley, and for Hutton's documents relating to this case. We appreciate Hutton's now stated intention to cooperate fully with the subcommittee's investigation.

As I have already noted, there will be other hearings on white collar crime generally, and on E.F. Hutton's case in particular. As the investigation proceeds, we look forward to hearing again from the company, perhaps from the same witnesses who appear here today, and perhaps from other officers and employees of Hutton. We do appreciate the willingness to cooperate at this time, and we look forward to working with you in the weeks ahead.

The Chair recognizes the gentlemen from Florida.

Mr. McCollum. Thank you, Mr. Chairman.

The hearing today focuses on one of the most complicated facts and patterns that I have ever encountered, and I, as you know, also served on the Banking Committee, so I see some of these, but nothing quite as complicated as this.

E.F. Hutton & Co. Inc.'s use of the inefficiencies within the bank check clearing system to obtain huge interest-free short-term loans from hundreds of banks without bank notice raises very difficult questions. Several schemes employed by mid-level E.F. Hutton personnel involve the control of up to $250 million of Federal Reserve and bank dollars by E.F. Hutton on a daily basis.

As a result of investigations dating back to December 1981, E.F. Hutton pleaded guilty to 2,000 counts of wire fraud and mail fraud. It received the highest white collar fine ever issued: $2 million. The company also agreed to a civil injunction that terminated several questionable continuing practices, and will provide restitution to injured banks throughout the country.

The hearing today presents an opportunity for us to understand these complicated facts, and review the Department of Justice's performance in prosecuting this case. Individuals were not charged, and it is important for us to collect the rationale for this key and controversial decision.

The Department of Justice has increased its emphasis on white collar crime, and I, like the chairman, am anxious to hear about the new trials resulting from this work. The Department of Justice will have an opportunity to explain their goals in this area in the future.

I do take note, Mr. Chairman, that, while the *G.E.* case and the *Bank of Boston* case have yet to produce prosecutions out of them, they are ongoing grand jury investigations, as opposed to this particular case, which is now a closed case. It is my understanding that a couple of individuals have been charged with perjury in the G.E. case, so we may yet see some activity different from that than we have in this one, and I hope that our future hearings will be timely in fashion with what you have outlined. I am sure they will be in regard to those ongoing cases.

Today, though, we focus on the recent example of the E.F. Hutton guilty plea. Corporate officials involved are in a special position to comment on the Department's work.

Another subject of prime importance to the subcommittee is the level of participation in the unlawful scheme within the corporation. According to the Department of Justice, two mid-level managers were responsible for the activities, which ultimately led to the plea agreement. I sincerely hope that today's hearing will shed some light on the knowledge, or lack of knowledge, of high-level corporate officials about the fraudulent activities, and the level of promptness with which these activities were terminated.

If the subcommittee is satisfied, the issues should be finally laid to rest. If criminal activity is uncovered, then the matter must be fully investigated.

Thank you, Mr. Chairman.

Mr. HUGHES. Thank you, gentleman.

Do any other members have an opening statement? Kentucky? West Virginia? Florida?

[No response.]

Mr. HUGHES. Our witnesses this morning are Mr. Robert Fomon, chairman of the board of the E.F. Hutton Group, Inc.; Mr. Thomas

Lynch, president of the E.F. Hutton Group, Inc.; Mr. Michael Castellano, comptroller of the E.F. Hutton Group, Inc.; and Mr. Thomas Morley, senior vice president and money mobilizer for the E.F. Hutton Co., Inc.

Gentlemen, on behalf of the Subcommittee on Crime we welcome you this morning. You may come forward, if you will, and take seats at the counsel table.

Pursuant to, and while you're getting comfortable at the witness table, I want to indicate that pursuant to clause 1 of rule 11, and clause 1 of rule 10, of the Rules of the House of Representatives, this hearing of the Subcommittee on Crime of the Committee on the Judiciary is an oversight investigation of the E.F. Hutton mail and wire fraud case.

Let the record indicate that, pursuant to clause 2 of rule 11 of the Rules of the House of Representatives, a copy of the rules of the Committee on the Judiciary, and copy of the clause 2 of rule 11 of the Rules of the House of Representatives has been made available to the witnesses, and is available at the witness table.

Gentlemen, I might advise you that you do have a right to have counsel assist you in the course of this morning's proceeding. Are you represented and accompanied by counsel this morning? They are free to join you if that is your desire.

Mr. FOMON. No, they are seated behind us.

Mr. HUGHES. All right, fine.

Gentlemen, I am going to now place you under oath. I wonder if you will stand and raise your right hand for me.

[Witnesses sworn.]

TESTIMONY OF ROBERT M. FOMON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, THE E.F. HUTTON GROUP, INC., E.F. HUTTON & CO., INC., ACCOMPANIED BY THOMAS LYNCH, PRESIDENT, E.F. HUTTON GROUP, INC.; THOMAS MORLEY, SENIOR VICE PRESIDENT, E.F. HUTTON & CO., INC.; AND MICHAEL CASTELLANO, COMPTROLLER, E.F. HUTTON & CO., INC.

Mr. HUGHES. Thank you. You may be seated.

Before we get underway, I'd like to take care of a housekeeping chore. One of the matters of critical importance to the subcommittee is for us to reach an understanding with you and E.F. Hutton regarding the full and final compliance with our subpoena of company records regarding the money management practices in question. As you know, we are examining this case in the context of oversight investigation of the Justice Department's handling of crimes involving corporate defendants. In order to adequately carry out this inquiry, we need to understand the entire anatomy of the case. This specifically includes the disposition of the civil case, as well as the criminal case, since the Justice Department correctly asserts that any fair evaluation of their handling of this case has to, of necessity, take into consideration the entire fact, criminal as well as civil.

In this context, I think you can understand why we need the subpoenas, including the information regarding these practices as they may have been occurring right up until the time of the plea and consent decree on May 2 of this year.

As I understand the communications we have exchanged with your counsel, while the company has not yet been able to fully comply with the subpoena for documents, you are still working toward full compliance, and will achieve it as soon as possible. Am I correct in that understanding?

Mr. FOMON. That is correct.

Mr. HUGHES. I think you can appreciate—we have, I guess, 250,000 pieces of paper at this point, and it's been a mammoth job, I know it was a mammoth job for you just to compile much of the information, and you can appreciate just how difficult it has been for this subcommittee since Friday. It is hard to wade through these documents, and even though we had staff working all weekend with five or six General Accounting Office auditors, it still is a mammoth task.

There is a lot of information we have not received, however, and we have not received any documents, for instance, from 1982 forward whatsoever that I am aware of. No memoranda from that period of time, from 1982 through 1985, the time of the plea. Much of the memoranda that we seek in that period from 1979 through 1982 has not been compiled, particularly memoranda and the documents from the branch offices and the regional offices. Can you give us some idea when this material will be available, Mr. Fomon, to the subcommittee?

Mr. FOMON. Well, we are going to furnish to you any information you want. The problem has been there are so many different documents, as you are aware. We furnished some 7 million documents to the grand jury. Based on your subpoena, it would appear that you are looking for more documents than we submitted to the grand jury, which was over a period of over a year.

These documents are located in over 400 different physical locations, so if you could help us, and tell us more specifically what it is you are looking for, we could do it more expeditiously. We have put out communications to every one of those physical locations to start assembling these documents.

Mr. HUGHES. Well, Mr. Fomon, staff did meet with your counsel Friday, a week ago, I recall, and some accord was reached, which was satisfactory to this member, and that was an effort to try and agree upon those areas where we felt pertinent documents should be produced. And then, as I understand it, why that agreement fell through.

We do have some specific areas of inquiry. I think that working in good faith we can arrive at those areas of particular importance.

You can appreciate that quite often documents will trigger a need for other documents, but we do have an idea in certain classifications in particular, where information is available that will be pertinent to this committee's inquiry.

For instance, many of the memoranda that exist in the branch offices bearing on progressive drawdown, or overdraft, are extremely pertinent to this inquiry. We have no such documents. The same thing with the regional offices. We have no such documents.

We have no memoranda, for instance, from headquarters, insofar as warnings to the branch offices or regional offices not to engage in such practices. I am not aware of any, in any event.

Mr. Fomon. I will certainly see that you get those kind of memoranda. I am surprised that you do not already have them. I am here to help this committee understand the situation.

As a matter of fact, I have always looked forward to this hearing. I did not resist coming to this hearing. I never responded that the Griffin Bell investigation would prevent me from appearing. As a matter of fact, the first communication to E.F. Hutton was not addressed to me. It was addressed to the president of E.F. Hutton. He responded to it. I was not aware of his response.

Mr. Hughes. I understand that. I accept that explanation. You can appreciate that the response I got, however, was from E.F. Hutton, and it was indicated in the response that we would just have to wait until Griffin Bell completed his inquiry.

Mr. Fomon. Well, that was a ridiculous response on our part.

Mr. Hughes. Let me get back, if I might, Mr. Fomon, to the documents that we need.

One of the things you make in your statement in chief is that, once the management at headquarters determined that there were serious overdrafting problems, you immediately notified the branch offices or regional offices. I would assume that that material is present at headquarters. We have no such written documentation.

Mr. Fomon. I will see that it is provided.

[Information follows.]

INTER-OFFICE MEMORA

TO Regional Operations Managers

FROM Thomas P. Morley

DATE March 11, 1982

SUBJECT Use of Reimbursement Checks

In order to insure the proper use of our branch reimbursement checks; I have outlined below the circumstances when we should use these checks.

The local branch should use our reimbursement checks only when the next days deposits are insufficient to bring our ledger balance to a positive $10,000. If this situation occurs, then the local cashier should draw a branch reimbursement check in the amount necessary to bring our ledger bank balance to plus $10,000. This is the only authorized use of our branch reimbursement checks. It is also imperative that a check should be entered into our ledger the day the check is written.

Please insure all your bank cashiers are aware of this procedure and it is strictly enforced.

Any questions regarding the above should be directed to the undersigned.

Tom

Bob Mercer

cc: Norman Epstein
Richard Genin
Robert Ross
Michael T. Vacca
Kevin O. Mahoney

A20-122

EFHutton
INTER-OFFICE MEMORANDUM

TO Robert Ross
FROM Thomas P. Morley
DATE February 23, 1982
SUBJECT Regional Draw Downs

Attached is the wire that went to the Regional VP's and Operations Managers confirming their draw down procedures.

Internal Audit should include this as part of their branch audit procedures.

cc: Norman Epstein
Richard Genin
Loren Schechter
Alan Brower

FC 14A (REV. 9/78)

TELEX

FROM: THOMAS P. MORLEY (MNY) 2/22/82

TO: REGIONAL VICE PRESIDENT (JDO) Mountain Region - Dale Frey
REGIONAL OPERATIONS MANAGER (JDO) Mountain Region - Joe Padilla

THIS WIRE IS TO CONFIRM THE AUTHORIZED DRAW DOWN PROCEDURE FOR YOUR REGION:

ALL BRANCHES IN YOUR REGION ARE DRAWN DOWN INTO UNTIED BANK OF DENVER AND THEN DIRECTLY DRAWN DOWN BY THE NEW YORK CASH DESK. THE ROSWELL, ALBUQUERQUE ~~AND TUCSON H-73~~ BRANCHES ARE DRAWN DOWN INTO ARIZONA BANK IN TUCSON AND THEN INTO UNITED BANK OF DENVER.

ANY CHANGES TO THIS POLICY MUST BE EXPRESSLY APPROVED IN WRITING BY THE UNDERSIGNED OR HIS SUPERVISOR.

PLEASE ACKNOWLEDGE RECEIPT OF THIS WIRE AND YOUR UNDERSTANDING AND AGREEMENT OF THESE PROCEDURES.

CC: THOMAS P. MORLEY (MNY)

TELEX

2/22/82

FROM: THOMAS P. MORLEY (MNY)

TO: REGIONAL VICE PRESIDENT (DBR) Atlantic Region - Jerry Miller
REGIONAL OPERATIONS MANAGER (DBR) Atlantic Region - Art Jensen

THIS WIRE IS TO CONFIRM THE AUTHORIZED DRAW DOWN PROCEDURE FOR YOUR REGION:

ALL YOUR UPSTATE BRANCHES ARE DRAWN DOWN DIRECTLY INTO LINCOLN BANK IN ROCHESTER. ALL OTHER BRANCHES ARE DRAWN DOWN DIRECTLY BY THE NEW YORK CASH DESK. LINCOLN IS THEN DRAWN DOWN BY THE NEW YORK CASH DESK. THE ONE APPROVED EXCEPTION IS THE HUNTINGTON, WEST VIRGINIA (A43) OFFICE WHICH IS DRAWN DOWN INTO NEW ENGLAND MERCHANTS BANK IN BOSTON.

Note Offices drawn down by Lincoln.

A-26 Batavia	A 37-Jamestown
A-28 Binghamton	A-38-Potsdam
A-30 Buffalo	A-46 Syracuse
A-34 Niagara Falls	A-47 Oneonta
A-36 Olean	A 82 Elmira

All remaining offices are drawn down by the New York Cash Desk.

ANY CHANGES TO THIS POLICY MUST BE EXPRESSLY APPROVED IN WRITING BY THE UNDERSIGNED OR HIS SUPERVISOR.

PLEASE ACKNOWLEDGE RECEIPT OF THIS WIRE AND YOUR UNDERSTANDING AND AGREEMENT OF THESE PROCEDURES.

CC: THOMAS P. MORLEY (MNY)

TELEX

FROM: THOMAS P. MORLEY (MNY) 2/22/82

TO: REGIONAL VICE PRESIDENT (CKC) Central Region - John Latshaw
REGIONAL OPERATIONS MANAGER (KCM) Central Region - Mike Wallace

THIS WIRE IS TO CONFIRM THE AUTHORIZED DRAW DOWN PROCEDURE FOR YOUR REGION:

ALL YOUR BRANCHES ARE DRAWN DOWN INTO COMMERCE BANK OF KANSAS CITY AND THEN DRAWN DOWN DIRECTLY - BY THE NEW YORK CASH DESK. APPROVED EXCEPTIONS ARE:

(1) C-16 WASHINGTON DC OFFICE

(2) C-17 BALTIMORE OFFICE

(3) C-18 WASHINGTON DC OFFICE

(4) C-25 NORFOLK, VA OFFICE

(5) C-32 BETHESDA

WHICH ARE DRAWN DOWN DIRECTLY BY THE NEW YORK CASH DESK, AND

(6) WICHITA, KANSAS - WHICH IS DRAWN DOWN FIRST INTO CONTINENTAL BANK IN CHICAGO, AND THEN BY NEW YORK CASH DESK.

ANY CHANGES TO THIS POLICY MUST BE EXPRESSLY APPROVED IN WRITING BY THE UNDERSIGNED OR HIS SUPERVISOR.

PLEASE ACKNOWLEDGE RECEIPT OF THIS WIRE AND YOUR UNDERSTANDING AND AGREEMENT OF THESE PROCEDURES.

CC: THOMAS P. MORLEY (MNY)

TELEX 2/22/82

FROM: THOMAS P. MORLEY (MNY)

TO: REGIONAL VICE PRESIDENT (GCM) MIDWEST REGION - AUSTIN DOREE
REGIONAL OPERATIONS MANAGER (GCM) MIDWEST REGION - MIKE GOLDSTEIN

THIS WIRE IS TO CONFIRM THE AUTHORIZED DRAW DOWN PROCEDURE FOR YOUR REGION:

ALL BRANCHES IN YOUR REGION ARE DRAWN DOWN INTO CONTINENTAL ILLINOIS NATIONAL BANK WHICH IS THEN DRAWN DOWN DIRECTLY BY THE NEW YORK CASH DESK. YOUR REGION ALSO DRAWS DOWN THE WICHITA, KANSAS BRANCH INTO CONTINENTAL ILLINOIS, WHICH IS THEN DRAWN DOWN BY NEW YORK.

ANY CHANGES TO THIS POLICY MUST BE EXPRESSLY APPROVED IN WRITING BY THE UNDERSIGNED OR HIS SUPERVISOR.

PLEASE ACKNOWLEDGE RECEIPT OF THIS WIRE AND YOUR UNDERSTANDING AND AGREEMENT OF THESE PROCEDURES.

CC: THOMAS P. MORLEY (MNY)

TELEX 2/22/82

FROM: THOMAS P. MORLEY (MNY)

TO: REGIONAL VICE PRESIDENT (KBO) New England Region - Bob Witt
REGIONAL OPERATIONS MANAGER (KBO) NEW England Region - Bob O'Neil

THIS WIRE IS TO CONFIRM THE AUTHORIZED DRAW DOWN PROCEDURE FOR YOUR REGION:

ALL BRANCHES IN YOUR REGION ARE DRAWN DOWN INTO NEW ENGLAND MERCHANTS WHICH IS THEN DRAWN DOWN DIRECTLY BY THE NEW YORK CASH DESK. THE HUNTINGTON WEST VIRGINIA BRANCH, WHICH IS OUTSIDE OF YOUR REGION, IS ALSO DRAWN DOWN INTO NEW ENGLAND MERCHANTS.

ANY CHANGES TO THIS POLICY MUST BE EXPRESSLY APPROVED IN WRITING BY THE UNDERSIGNED OR HIS SUPERVISOR.

PLEASE ACKNOWLEDGE RECEIPT OF THIS WIRE AND YOUR UNDERSTANDING AND AGREEMENT OF THESE PROCEDURES.

CC: THOMAS P. MORLEY (MNY)

TELEX 2/22/82

FROM: THOMAS P. MORLEY (MNY)

TO: REGIONAL VICE PRESIDENT (FRA) Pacific South Region - Herb Kawahara
REGIONAL OPERATIONS MANAGER (ALA) Pacific South Region-Bob Mencer

THIS WIRE IS TO CONFIRM THE AUTHORIZED DRAW DOWN PROCEDURE FOR YOUR REGION:

ALL BRANCHES IN YOUR REGION ARE DRAWN DOWN INTO EITHER BANK OF AMERICA, SECURITY PACIFIC OR FIRST INTERSTATE IN LOS ANGELES, AND THEN DRAWN DOWN DIRECTLY BY THE NEW YORK CASH DESK.

ANY CHANGES TO THIS POLICY MUST BE EXPRESSLY APPROVED IN WRITING BY THE UNDERSIGNED OR HIS SUPERVISOR.

PLEASE ACKNOWLEDGE RECEIPT OF THIS WIRE AND YOUR UNDERSTANDING AND AGREEMENT OF THESE PROCEDURES.

CC: THOMAS P. MORLEY (MNY)

TELEX 2/22/82

FROM: THOMAS P. MORLEY (MNY)

TO: REGIONAL VICE PRESIDENT (ALA) Pacific North Region - Tom Belshe
REGIONAL OPERATIONS MANAGER (ALA) Pacific North Region -Bob Mencer

THIS WIRE IS TO CONFIRM THE AUTHORIZED DRAW DOWN PROCEDURE FOR YOUR REGION:

ALL BRANCHES IN YOUR REGION ARE DRAWN DOWN INTO EITHER BANK OF AMERICA OR SECURITY PACIFIC IN L.A. AND THEN DRAWN DOWN DIRECTLY BY THE NEW CASH DESK.

ANY CHANGES TO THIS POLICY MUST BE EXPRESSLY APPROVED IN WRITING BY THE UNDERSIGNED OR HIS SUPERVISOR.

PLEASE ACKNOWLEDGE RECEIPT OF THIS WIRE AND YOUR UNDERSTANDING AND AGREEMENT OF THESE PROCEDURES.

CC: THOMAS P. MORLEY (MNY)

TELEX

2/22/82

FROM: THOMAS P. MORLEY (MNY)

TO: REGIONAL VICE PRESIDENT (ATO) South East Region - Ralph Williams
REGIONAL OPERATIONS MANAGER (ATO) South East Region - Joe McAdams

THIS WIRE IS TO CONFIRM THE AUTHORIZED DRAW DOWN PROCEDURE FOR YOUR REGION:

ALL BRANCHES IN YOUR REGION ARE DRAWN DOWN INTO TRUST COMPANY OF GEORGIA AND THEN DIRECTLY BY THE NEW YORK CASH DESK.

ANY CHANGES TO THIS POLICY MUST BE EXPRESSLY APPROVED IN WRITING BY THE UNDERSIGNED OR HIS SUPERVISOR.

PLEASE ACKNOWLEDGE RECEIPT OF THIS WIRE AND YOUR UNDERSTANDING AND AGREEMENT OF THESE PROCEDURES.

CC: THOMAS P. MORLEY (MNY)

TELEX

FROM: THOMAS P. MORLEY (MNY) 2/22/82

TO: REGIONAL VICE PRESIDENT (JPO) SOUTH CENTRAL REGION - Michael Jud
REGIONAL OPERATIONS MANAGER (HOU) SOUTH CENTRAL REGION - Jerry Webe

THIS WIRE IS TO CONFIRM THE AUTHORIZED DRAW DOWN PROCEDURE FOR YOUR REGION:

> ALL YOUR BRANCHES ARE DRAWN DOWN INTO EITHER TEXAS COMMERCE - HST OR REPUBLIC BANK IN DALLAS. (SEE ATTACHED LIST)
> BOTH OF THESE BANKS ARE THEN DRAWN DOWN DIRECTLY BY THE NEW YORK CASH DESK.

ANY CHANGES TO THIS POLICY MUST BE EXPRESSLY APPROVED IN WRITING BY THE UNDERSIGNED OR HIS SUPERVISOR.

PLEASE ACKNOWLEDGE RECEIPT OF THIS WIRE AND YOUR UNDERSTANDING AND AGREEMENT OF THESE PROCEDURES.

CC: THOMAS P. MORLEY (MNY)

NY-

Texas Commerce -HST

N-93- Greenway Plaza Hst
N-61 Hst Post Oak.
N-07 Hst St. Mary
N-05 Hst West Loop
N-87 Hst. Nat. Office
N-47 Baton Rouge -La
N-49 Mobile Ala.
N-89 Austin Texas
N-60 New Orleans- Shale
N-02 Waco- Texas
N-86- Longview Texas
N-90 Beaumont- Tx

NY

Republic Bank-Dallas

N01- Dallas-
N-34 Dallas-
N-04 Midland Texas
N-46- New Orleans-
N-14 Ft. Worth
N-40 Shreveport
N-92 San Antonio
N-32 Oklahoma City
N-48 Lafayette La-
N-91 Bryan Texas
N-84 Tyler Texas
N-81 Lubbock Texas
N-85 Wichita Falls Tx.
N-82 Dallas Bryan Tower

~~222 GNA 61 ALD~~ 051382/1640-42
QLA & QSF - CASHIERS PACIFIC NORTH & SOUTH REGIONS

460

CC QLA & QSF - BRANCH MANAGERS
CC FRA - TOM BELSHE
CC ALA - HERB KAWAHARA
CC ALA - JACK LEES
CC ALC - ROBERT HEIN
CC ALC - MARK WILLETS
CC ALC - HELEN LEVIS
CC ALA - BOB MENCER

VERY IMPORTANT

PURSUANT TO TODAYS CONFERENCE CALL WITH NEW YORK SENIOR OFFICERS — ~~EFFECTIVE IMMEDIATELY AND UNTIL FURTHER NOTICE THE DAILY DRAWDOWN~~ PROCEDURES ARE REVISED AS FOLLOWS:

ON YOUR DAILY DRAWDOWN WORKSHEET (GOOD FUNDS) PART I AND PART II SUB-BALANCE SHOULD BE CHANGED TO READ "ON MONDAY, TUESDAY, WEDNESDAY AND FRIDAY MULTIPLY BY ONE. ON THURSDAY DIVIDE BY THREE."

THIS MEANS THAT YOU DO NOT MULTIPLY BY 3 ON FRIDAY OR MONDAY UNDER ANY CIRCUMSTANCES.

EVERY CASHIER WILL FOLLOW THESE INSTRUCTIONS WITHOUT FAIL. THESE INSTRUCTIONS MAY NOT BE SUPERCEDED BY ANYONE AT THE BRANCH OR REGIONAL LEVEL.

NEW YORK HAS ASSURED US THAT A NEW REVISED AND SIMPLIFIED DRAWDOWN SHEET WILL BE MADE AVAILABLE TO THE BRANCHES IN THE VERY NEAR FUTURE.

JACK LEES, MARK WILLETS, BOB HEIN AND HELEN LEVIS WILL BE CALLING EACH AND EVERY ONE OF YOU TODAY TO FURTHER CLARIFY THIS CHANGE IN PROCEDURES.

R. MENCER - ALA

~~[illegible]~~ TOR @ ZMYO 051482/16MS-11
ALL CASHIERS
SANDY

FROM NOW ON THE FOLLOWING SHOULD BE THE
DRAWDOWN FORMAT USED BY ALL BRANCHES:

OPENING BALANCE (SHOULD BE ZERO)
PLUS (+) DEPOSITS
MINUS (-) ANY LOCAL CHECKS, RETURNED
CHECKS OR CHARGES AGAINST YOUR
BANK ACCOUNT
TOTAL:
IF POSITIVE, THAT FIGURE IS YOUR
DRAWDOWN

IF NEGATIVE, ISSUE A US$ CHECK FOR THE
DIFFERENCE AND THERE IS NO DRAWDOWN

YOUR OPENING & CLOSING BALANCE SHOULD
ALWAYS BE ZERO. (IN SOME CASES IT MAY
BE A POSITIVE FIGURE.)
PLS CALL IF YOU SHOULD HAVE QUESTIONS.
SANDY MILLER ATO

[illegible] ZNYO 061482/1308-10
ALL CASHIERS
FACE FACE FACE
TODAY ALL BRANCHES MUST DRAWDOWN TO
ZERO.
NO OVERDRAW IS ALLOWED.
IF YOU DO NOT TAKE IN ENOUGH TO
COVER YOUR OVERDRAW FROM THURSDAY
YOU MUST DEPOSIT A UST CHECK.

NEW YORK WILL BE MONITORING ALL
ACCOUNTS.

REPEAT-ALL BRANCHES FROM NOW ON
MUST DRAW DN TO ZERO .
IF MANAGERS QUESTION THIS HAVE
THEM CALL MR. MCADAMS.

SANDY MILLER ATO

EFHutton

INTER-OFFICE MEMORANDUM

660

TO: Cashiers - Pacific North & South
cc: Branch Managers

FROM: Robert Mencer

DATE: May 17, 1982

SUBJ: DRAWDOWNS

As promised in Friday's wire, here is the clarification regarding the banking drawdowns. We told you to discontinue use of the worksheet and to bring your bank balances to zero. Also, we informed you that the cut-off time for calling in drawdowns to ALC would be extended to 1:30 P.M.

The example offered Friday to bring your bank accounts to zero still is in effect. But starting today, you must call in the amount of your daily drawdown by 1:30 P.M. as follows:

1. All customers' checks (and cash) received by the cut-off must be blottered, transmitted by wire, and deposited at the bank. Remember, you can prepare blotters, have wires transmitted and go to the bank after the cut-off.

IMPORTANT NOTE 2. All checks received after the cut-off may be blottered and deposited at the bank, but they cannot be transmitted over the wire because they will not have been included in the drawdown.

3. It is not mandatory to deposit checks received after the cut-off but it is recommended. If the amounts are in excess of $25,000 and it is possible to take them to the bank, we urge you to do so. Those checks that cannot be deposited, must be placed in the night drop bag.

4. There are many offices reporting to Los Angeles, thus it is not possible for all of you to call at exactly 1:30 P.M. Therefore, you must cut-off as close to 1:30 P.M. as possible, ie order to have called by 1:30 P.M. Please note, and this is important, your telephone call is your actual cut-off. Once you have called in the drawdown, all checks received afterwards cannot be transmitted by wire even though you may be able to deposit them in the bank.

5. It is no longer necessary to estimate late deposits since moneys received by your cut-off will be included in the drawdown and those received after you have cut-off will not be transmitted (whether they are deposited in the bank or placed in the night drop bag).

6. If your bank balances finish in the negative, that is, in the red, you must bring them to zero by depositing a U.S. Trust check. Since you do not generally disburse local funds, this should not be necessary too often.

7. Here again is the example for determining your drawdown:

- Opening EFH ledger balance on our books ____________
- Plus today's deposit ____________
- Minus local checks if any ____________
- Net balance to be drawndown ____________

To summarize, effective right now, all bank balances will be brought to zero, repeat zero balance and you will disregard the drawdown worksheets. The cut-off time for calling in drawndowns is now 1:30 P.M. Anything received after the cut-off will be transmitted the next day. If there are any questions, you may contact the Regional Cashiering Dept. and talk to Bob Hein, Helen Levis or Mark Willets.

Branch Managers & Cashiers - PLEASE NOTE - while on the subject of banking procedures, let me comment on the processing of disbursements (payment of BOA drafts). Because of the drawdown cut-off, we cannot transmit deposits after determining the amount to be drawndown but this cut-off does not apply to the reporting of payments of BOA drafts which can be transmitted much later. In fact, it is imperative to transmit all drafts paid each day if possible. Since the wire system shuts down at 3:15 P.M. - Pacific Daylight Time - it is possible to process BOA drafts much longer. Since you need some processing time, I am setting 2:45 P.M. (Pacific Time) as the cut-off for transmitting BOA disbursements. Those offices where the wire operator leaves before this time must have a trained back-up operator or cashier who can transmit drafts.

Thanks, R Mencer

R. MENCER

cc: T. Belshe'
H. Kawahara
R. Hein
H. Levis
M. Willets

P.S. MANAGERS PLEASE NOTE --

1. The failure to transmit BOA drafts the same day they are paid negatively impacts your interest P+L. Every effort should be made to transmit BOA drafts as late as possible.

2. Receipt of customer deposits up to 1:30 P.M. must be processed the same day. Failure to do so will result in interest adjustments and problems with CRM orders etc. Deposits received after the 1:30 cut-off must not be transmitted.

252 ENS 21 DLA 051782/1601-02

PART 2 OF 2 PARTS

TO: CASHIERS - PACIFIC NORTH & SOUTH
CC: BRANCH MANAGERS

CC: T. BELSHE
H. KAWAHARA
R.HEIN

H LEWIS
M. WILLETS
R. MENCER

FROM: ROBERT MENCER

DATE: MAY 17, 1982

SUBJ: DRAWDOWNS

BRANCH MANAGERS & CASHIERS - PLEASE NOTE - WHILE ON THE SUBJECT OF BANKING PROCEDURES, LET ME COMMENT ON THE PROCESSING OF DISBURSEMENTS (PAYMENTS OF BOA DRAFTS). BECAUSE OF THE DRAWDOWN CUT-OFF, WE CANNOT TRANSMI DEPOSITS AFTER DETERMINING THE AMOUNT TO BE DRAWNDOWN BUT THIS CUT-OFF DOES NOT APPLY TO THE REPORTING OF PAYMENTS OF BOA DRAFTS WHICH CAN BE TRANSMITTED MUCH LATER. IN FACT, IT IS IMPERATIVE TO TRANSMIT ALL DRAFTS PAI EACH DAY IF POSSIBLE. SINCE THE WIRE SYSTEM SHUTS DOWN AT 3:15 P.M. - PACIFIC DAYLIGHT TIME - IT IS POSSIBLE TO PROCESS BOA DRAFTS MUCH LONGER. SINCE YOU NEED SOME PROCESSING TIME, I AM SETTING 2:45 P.M. (PACIFIC TIME) AS THE CUT-O FOR TRANSMITTING BOA DISBURSEMENTS. THOSE OFFICES WHERE THE WIRE OPERATOR LEAVES BEFORE THIS TIME MUST HAVE A TRAINED BACK-UP OPERATOR OR CASHIER WHO CAN TRANSMIT DRAFTS.

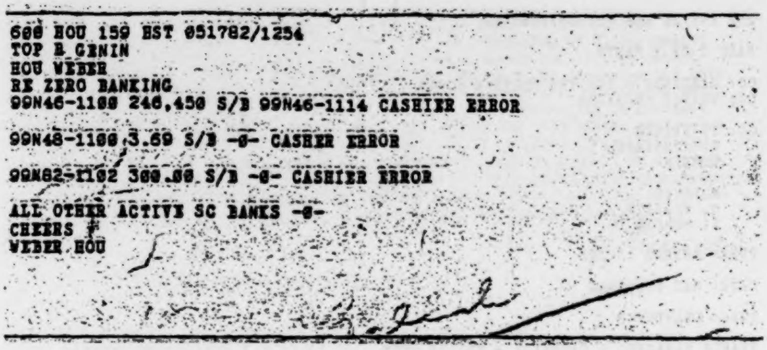
P.S. MANAGERS PLEASE NOTE --

1. THE FAILURE TO TRANSMIT BOA DRAFTS THE SAME DAY THEY ARE PAID NEGATIVELY IMPACTS YOUR INTEREST P+L. EVERY EFFORT SHOULD BE MADE TO TRANSMIT BOA DRAFTS AS LATE AS POSSIBLE.

2. RECEIPT OF CUSTOMER DEPOSITS UP TO 1:30 P.M. MUST BE PROCESSED THE SAME DAY. FAILURE TO DO SO WILL RESULT IN INTEREST ADJUSTMENTS AND PROBLEMS WITH CRM ORDERS, ETC.
DEPOSITS RECEIVED AFTER THE 1:30 CUT-OFF MUST NOT BE TRANSMITTED

END PART 2 OF 2 PARTS

THANKS - R. MENCER



```
600 HOU 159 EST 051782/1254
TOP B GENIN
HOU WEBER
RE ZERO BANKING
99N46-1100 246,450 S/B 99N46-1114 CASHIER ERROR

99N48-1100 3.69 S/B -0- CASHER ERROR

99N82-1102 300.00 S/B -0- CASHIER ERROR

ALL OTHER ACTIVE SC BANKS -0-
CHEERS
WEBER HOU
```

618 GCM 0 TLA 022382/1818

FM: THOMAS P. MORLEY (MNY)
TO: REGIONAL VICE PRESIDENT
(GCM MIDWEST REGION - AUSTIN DOREE

REGIONAL OPERATIONS MANAGER
(GCM) MIDWEST REGION - MIKE GOLDSTEIN

REPEATING AND CORRECTING

THIS WIRE IS TO CONFIRM THE AUTHORIZED DRAW DOWN PROCEDURE FOR YOUR REGION:

ALL BRANCHES IN YOUR REGION ARE DRAWN DOWN INTO CONTINENTAL ILLINOIS NATIONAL BANK WHICH IS THEN DRAWN DOWN DIRECTLY BY THE NEW YORK CASH DESK. YOUR REGION ALSO DRAWS DOWN THE WICHITA, KANSAS BRANCH INTO CONTINENTAL ILLINOIS, WHICH IS THEN DRAWN DOWN BY NEW YORK.

ANY CHANGES TO THIS POLICY MUST BE EXPRESSLY APPROVED IN WRITING BY THE UNDERSIGNED OR HIS SUPERVISOR.

PLEASE ACKNOWLEDGE RECEIPT OF THIS WIRE AND YOUR ANDERSTANDING AND AGREEMENT OF THESE PROCEDURES.

THOMAS P. MORELEY/MNY

107 CHM 1 GBM 022582/1037-58
MNY MORLEY
GCG DOREE
CHM GOLDSTEIN

CONFIRMING YOUR WIRE RE DRAW DOWN PROCEDURE FOR MIDWEST REGION

WE DRAW DOWN ALL BRANCHES INTO CONTINENTAL ILLINOIS N.B. WHICH IS THEN DRAWN DOWN BY N.Y. CASH DESK. CHANGES WILL BE REQUESTED IN WRITING.

REGARDS,
M GOLDSTEIN CHM

247 JNS 19 TLA 051782/1552-55

PART 1 OF 2 PARTS

TO: CASHIERS - PACIFIC NORTH & SOUTH
CC: BRANCH MANAGERS

CC: T. BELSBE
R. SAVANARA
R.KLIN

H LEWIS
M. WILLETS
R. MENCER

FROM: ROBERT MENCER

DATE: MAY 17, 1982

SUBJ: DRAWDOWNS

AS PROMISED IN FRIDAY'S WIRE, HERE IS THE CLARIFICATION REGARDING THE BA DRAWDOWNS. WE TOLD YOU TO DISCONTINUE USE OF THE WORKSHEET AND TO BRING BANK BALANCES TO ZERO. ALSO, WE INFORMED YOU THAT THE CUT-OFF TIME FOR CALLING IN DRAWDOWNS TO ALC WOULD BE EXTENDED TO 1:30 P.M.

THE EXAMPLE OFFERED FRIDAY TO BRING YOUR BANK ACCOUNTS TO ZERO STILL IS I EFFECT. BUT STARTING TODAY, YOU MUST CALL IN THE AMOUNT OF YOUR DAILY DRAWDOWN BY 1:30 P.M. AS FOLLOWS:

1. ALL CUSTOMERS' CHECKS (AND CASH) RECEIVED BY THE CUT-OFF MUST BE BLOTTERED, TRANSMITTED BY WIRE, AND DEPOSITED AT THE BANK. REMEMBER, YOU CAN PREPARE BLOTTERS, HAVE WIRES TRANSMITTED AND GO TO THE BANK AFTER THE CUT-OFF

2. ALL CHECKS RECEIVED AFTER THE CUT-OFF MAY BE BLOTTERED AND DEPOSITED AT THE BANK, BUT THEY CANNOT BE TRANSMITTED OVER THE WIRE BECAUSE THEY WILL NOT HAVE BEEN INCLUDED IN THE DRAWDOWN.

3. IT IS NOT MANDATORY TO DEPOSIT CHECKS RECEIVED AFTER THE CUT-OFF BUT IT IS RECOMMENDED. IF THE AMOUNTS ARE IN EXCESS OF $25,000 AND IT IS POSSIBLE TAKE THEM TO THE BANK, WE URGE YOU TO DO SO. THOSE CHECKS THAT CANNOT BE DEPOSITED, MUST BE PLACED IN THE NIGHT DROP BAG.

4. THERE ARE MANY OFFICES REPORTING TO LOS ANGELES. THUS IT IS NOT POSSI FOR ALL OF YOU TO CALL AT EXACTLY 1:30 P.M. THEREFORE, YOU MUST CUT-OFF AS CLOSE TO 1:30 P.M. AS POSSIBLE, IN ORDER TO HAVE CALLED BY 1:30 P.M. PLE NOTE, AND THIS IS IMPORTANT, YOUR TELEPHONE CALL IS YOUR ACTUAL CUT-OFF. ONCE YOU HAVE CALLED IN THE DRAWDOWN, ALL CHECKS RECEIVED AFTERWARDS CANN BE TRANSMITTED BY WIRE EVEN THOUGH YOU MAY BE ABLE TO DEPOSIT THEM IN THE

5. IT IS NO LONGER NECESSARY TO ESTIMATE LATE DEPOSITS SINCE MONEYS RECE BY YOUR CUT-OFF WILL BE INCLUDED IN THE DRAWDOWN AND THOSE RECEIVED AFTE HAVE CUT-OFF WILL NOT BE TRANSMITTED (WHETHER THEY ARE DEPOSITED IN THE OR PLACED IN THE NIGHT DROP BAG).

6. IF YOUR BANK BALANCES FINISH IN THE NEGATIVE, THAT IS, IN THE RED, Y MUST BRING THEM TO ZERO BY DEPOSITING A U.S. TRUST CHECK. SINCE YOU DO GENERALLY DISBURSE LOCAL FUNDS, THIS SHOULD NOT BE NECESSSARY TOO OFTEN.

7. HERE AGAIN IS THE EXAMPLE FOR DETERMINING YOUR DRAWDOWN:

- OPENING THE LEDGER BALANCE ON OUR BOOKS -------------
- PLUS TODAY'S DEPOSIT -------------
- MINUS LOCAL CHECKS IF ANY -------------
- NET BALANCE TO BE DRAWDOWN -------------

TO SUMMARIZE, EFFECTIVE RIGHT NOW, ALL BANK BALANCES WILL BE BROUGHT TO Z REPEAT ZERO BALANCE AND YOU WILL DISREGARD THE DRAWDOWN WORKSHEETS. THE CUT-OFF TIME FOR CALLING IN DRAWDOWNS IS NOW 1:30 P.M. ANYTHING RECEIVE AFTER THE CUT-OFF WILL BE TRANSMITTED THE NEXT DAY. IF THERE ARE ANY QUESTIONS, YOU MAY CONTACT THE REGIONAL CASHIERING DEPT. AND TALK TO EI HELEN LEWIS OR MARY WILLETS.

END PART 1 OF 2 PARTS

THANKS - R. MENCER

253 JNS 20 DLA 051782/1559-1600

PART 2 OF 2 PARTS

TO: CASHIERS - PACIFIC NORTH & SOUTH
CC: BRANCH MANAGERS

CC: T. BELSEE
H. KAWAHARA
R.HEIN

H LEWIS
M. WILLETS
R. MENCER

FROM: ROBERT MENCER

DATE: MAY 17, 1982

SUBJ: DRAWDOWNS

BRANCH MANAGERS & CASHIERS - PLEASE NOTE - WHILE ON THE SUBJECT OF BANKI
PROCEDURES, LET ME COMMENT ON THE PROCESSING OF DISBURSEMENTS (PAYMENTS OF BOA DRAFTS). BECAUSE OF THE DRAWDOWN CUT-OFF, WE CANNOT TRA
DEPOSITS AFTER DETERMINING THE AMOUNT TO BE DRAWNDOWN BUT THIS CUT-OFF DO
APPLY TO THE REPORTING OF PAYMENTS OF BOA DRAFTS WHICH CAN BE —
TRANSMITTED MUCH LATER. IN FACT, IT IS IMPERATIVE TO TRANSMIT ALL DRAFTS
EACH DAY IF POSSIBLE. SINCE THE WIRE SYSTEM SHUTS DOWN AT 3:15 P.M. - PA
DAYLIGHT TIME - IT IS POSSIBLE TO PROCESS BOA DRAFTS MUCH LONGER. SINCE
NEED SOME PROCESSING TIME, I AM SETTING 2:45 P.M. (PACIFIC TIME) AS THE C
FOR TRANSMITTING BOA DISBURSEMENTS. THOSE OFFICES WHERE THE WIRE OPERATO
LEAVES BEFORE THIS TIME MUST HAVE A TRAINED BACK-UP OPERATOR OR CASHIER W
CAN TRANSMIT DRAFTS.

P.S. MANAGERS PLEASE NOTE —

1. THE FAILURE TO TRANSMIT BOA DRAFTS THE SAME DAY THEY ARE PAID NEGATIVELY IMPACTS YOUR INTEREST P&L. EVERY EFFORT SHOULD BE MADE TO TRANSMIT BOA DRAFTS AS LATE AS POSSIBLE.

2. RECEIPT OF CUSTOMER DEPOSITS UP TO 1:30 P.M. MUST BE PROCESSED THE SAME DAY. FAILURE TO DO SO WILL RESULT IN INTEREST ADJUSTMENTS AND PROBLEMS WITH CRM ORDERS, ETC.
DEPOSITS RECEIVED AFTER THE 1:30 CUT-OFF MUST NOT BE TRANSMITTED

END PART 2 OF 2 PARTS

THANKS - R. MENCER

Mr. **Hughes**. There is a great deal of additional information that I think we can best walk through, if in fact we do it in a spirit of cooperation. We don't want to put the company to the burden of going through 8 or 10 million documents, and we don't want to have to go through that many documents. That is kind of ridiculous. But we are prepared to do that, in fact, if that is what we have to do to get the information we want. But I think that it would serve your interests and the interests of this committee if we can agree upon a scenario whereby we identify those documents which we feel are crucial, and work on—in those areas there are some classifications where there are very few documents, if any available. It should be very easy to satisfy our needs in those areas.

Mr. **Fomon**. I agree with you completely. I think that's only proper. As a matter of fact I will help you with a roadmap.

Mr. **Hughes**. Thank you. We appreciate that.

We would also welcome the assistance of some of your folks at headquarters, as well as at the regional and branch offices, to work with us in explaining some of the documents so that we can fully understand what some of them mean. That would be very helpful, too.

Mr. **Fomon**. I will instruct them to give their full cooperation.

Mr. **Hughes**. Before you get into your statement, I would like to make a statement of facts to make sure that we are working on the same premise, and I would invite you, or your colleagues at E.F. Hutton to make any corrections that you might want to make in the statement of facts as we understand them.

I think as my colleague from Florida, Mr. McCollum, the ranking Republican, has indicated, we are talking about a very, very complicated case. I have worked on a lot of complicated matters, but this certainly is one of the more complicated matters, and we expect that the witnesses representing E.F. Hutton will have some comments on the statement, if in fact we misinterpreted any of the facts.

I believe, however, as much as possible, we should try to be clear as to what it is that E.F. Hutton did that led it to plead guilty to 2,000 counts of mail and wire fraud last month.

The Department of Justice has said that many of the practices in which E.F. Hutton engaged were widespread, were illegal, and endangered the entire banking system in the country. Hutton says that many of the practices were simply aggressive money management, were entirely legal, and created no danger to the public at all.

These are key questions that must be considered at this hearing, but cannot be resolved without a clear understanding of the facts. I will begin by describing, as I have indicated, what I understand Hutton's system for cash concentration was.

Every business, and indeed every individual, wants immediate availability of funds. When I deposit a check in my checking account, I want to be able to immediately drawdown the funds represented by that check. It may be, however, that the bank will not allow me to do so. In some cases, in fact, it may be illegal to do so.

Hutton's cash concentration system, as I understand it, was developed so that the company could concentrate in New York all the customer funds deposited in its local or branch banks on the same day that the funds were deposited, and so that the next morning Hutton would be able to withdraw the money, or otherwise have use of it, and I understand that some of the funds would have gone to Los Angeles also for that purpose. So you had two centers where funds would be concentrated.

According to the system, each Hutton branch office would tell the Hutton regional office how much in customer funds was deposited on a given day, and the regional office would draw those funds down and deposit them in the regional bank. The same process would then occur between Hutton's regional office and its office in New York or Los Angeles, where Hutton had, as I have indicated, its other prime concentration account.

The process involved regular communication among Hutton employees on various levels of the company.

Hutton maintained bank accounts on the branch, regional, and national level, as I have described. It also maintained several zero balance accounts at Chemical and U.S. Trust Banks in New York, and at the Bank of America in Los Angeles. Hutton was not required to maintain a balance in these accounts, but could write checks freely on them, and cover them as checks were presented for payment. Hutton was concerned, as are the banks themselves, about losing money through the so-called float, the time it takes checks to clear, that is.

If Hutton money is deposited in a bank, and Hutton does not get immediate use of that money, Hutton would claim it is injured by float, and that the bank is using Hutton's money. Hutton thus devised what is called a drawdown sheet, which instructs Hutton branch and regional employees through a series of mathematical calculations, how much to withdraw from Hutton's branch and regional bank accounts.

Among other calculations required by the drawdown sheet, employees were instructed to use a multiplier factor that called for the withdrawal of more funds than Hutton actually had deposited that particular day. This was allegedly to compensate Hutton for the fact that some of the funds deposited on that day were immediately available, funds such as cash or checks drawn on that very same bank or depository.

It also compensated Hutton for weekends, when the banks would have the use of Hutton's money for more than one night.

Use of the multiplier factor escalated. Hutton employees began making what the Government calls arbitrary and excessive drawdown. In other words, instead of using the mathematical formula to determine how much to draw down its accounts, they began making enormous overdrafts that had no relation whatsoever to the amounts of funds deposited that particular day. On a $70,000 deposit, for instance, Hutton would draw down and deposit in New York almost $10 million, and withdraw that amount the next day. This amount is not hypothetical, but refers to an actual transaction cited by the Department of Justice at the court hearing in which the company's guilty plea was accepted.

To cover the overdraft, Hutton would write checks on its zero balance account, and deposit them in the branch bank. Meanwhile the branch bank would have in essence loaned Hutton almost $10 million, without being made aware of that loan, and without charging Hutton for the use of its money.

The zero balance account check would take a longer time to clear than would local customer checks, thus Hutton benefited from the float of the zero balance accounts.

Hutton took advantage of the float in another way, as I understand it. It began to create multiple transfers, or chains, by which checks were simultaneously drawn and deposited on a number of branch banks, regional banks, and finally the prime concentration accounts. In addition, each time each of the branch banks was drawn down, the amount of the drawdown increased. For example, if $10 was deposited in the first branch bank, the second branch bank would draw down by $30, and the third branch bank would draw the second one down by $90. Each of the overdrafts was covered by a zero balance account check.

In the chaining situation thus referred to, Hutton benefited from the float in two different ways. First, through the amount of time it took each check to clear through the chain, and second, through the amount of time it took the zero balance account checks to clear. If a check did not clear the branch bank on the second day, for example, the branch bank ledger account would still show that amount on deposit, even though Hutton had drawn down that amount on the previous day, it would then draw down again on the second day, in some instances, to cover the overdraft again with a zero balance account check.

One crucial question raised by these activities involves the proper and legal circumstances in which an individual or business may withdraw money from a checking account. May checks be drawn on collected funds? I think the answer is clearly yes. On uncollected funds, the answer, I believe, often depends on whether the customer is an individual or a business in relationship with the bank. On nonexistent balances such as those that occur when checks are drawn for more than the amount deposited, that is a question we will explore today.

On created balances, such as those created when a Hutton check drawn on uncollected or nonexistent funds or bogus funds is deposited, and immediately drawn against, we will also explore that particular question today.

We do know that the effect of Hutton's practices was to provide Hutton with interest-free loans from a number of generally small rural banks, often without the consent or knowledge of those institutions. Some banks that became aware of the practices threatened to close Hutton's account if the persistent and large overdrafting did not cease. Some banks did close Hutton accounts after discovering these practices. On any given day, Hutton might be as much as a quarter million dollars overdrawn on various banks.

As I indicated earlier, these are very complicated facts.

Now I would like to hear if there are any representations that I have made that are not accurate, any parts of that general statement that you want to correct.

Mr. **Fomon**. Well, as you indicated, it is a very complex, complicated situation. I think that you have a very good grasp of it.

If I could make a few comments on your statement, and then I would ask Mr. Morley to comment on your statement.

Mr. Hughes. I wonder if I could do this: so that to give you an opportunity to talk with your other officers about a very lengthy statement, to make sure that each area that has to be corrected is corrected, we are going to take a recess and then vote. We have two votes ahead of us right now, and so we are going to recess for 15 minutes to catch these votes.

I'm not sure if you are familiar with the procedure around here, but we live by the bells, and we apologize for these interruptions, but it is the way we have to do business.

So we are going to recess at this point for 15 minutes. We'll be back shortly.

[Recess.]

Mr. Hughes. Mr. Fomon, I think when we recessed my question was whether or not there were any areas in the statement of fact to which you would either want to make some additions or some corrections.

Mr. Fomon. Yes, thank you.

Early in the statement, you quoted the Justice Department as saying that any of the practices in which Hutton engaged were widespread, illegal, and endangered the entire banking system in this country.

I don't think the Justice Department said that our practices endangered the entire banking system in the country. I think what they implied was, were corporations with less financial stability to engage in these practices, it could have endangered the banking system, but you should remember that there was never an instance where we did not cover, and have the ability to cover every check that we wrote.

But what they're getting to is that, if a company did not have the financial stability of an E.F. Hutton, it could endanger the banks.

Mr. Hughes. OK. Thank you.

Any other areas?

Mr. Fomon. On zero balance accounts: Zero balance accounts are a service to corporations which are actually promoted by banks. Banks sell these services for a fee, and they encourage zero balance accounts.

Mr. Hughes. So they are different than the usual bank accounts.

Mr. Fomon. Right. And they are only available to corporations. It's a very common practice in America.

It says you stated that if Hutton money is deposited in a bank, and Hutton does not get immediate use of that money, Hutton would claim it is injured by float.

No; we don't expect to get immediate use of money. We understand that banks are entitled to profit for their services performed. And that profit can be in a number of forms. It can be based on their having available collected balances, or it can be based on a negotiated fee.

Mr. Hughes. So you are concerned it was—was it the use of the term "immediate?"

Mr. Fomon. Yes.

Mr. Hughes. What would you suggest would be more appropriate?

Mr. Fomon. I'd take out the sentence altogether.

Mr. HUGHES. Well, the practice, as I understand it, was to have access in concentrated form at the earliest possible time.

Mr. FOMON. Actually, banks are interested in making a profit on their services, and they are entitled to make a profit on their services. In most instances, the corporate depositor enters into an agreement with the depository bank that they will leave a balance of $10,000 or $100,000 on average. The bank doesn't care if the balance is there every single day. They do account analysis and look at it over a period of time, over a period of 1 month, or 3 months, and they want to see that they have sufficient available funds in the bank on average.

Mr. HUGHES. Mr. Fomon, I really don't understand the point then.

As I understand the practice, it was to draw down each day to practically zero in these branch banks to have fast access to that money for investment and other purposes at a central occasion.

Mr. FOMON. Let me see if I can help you.

In your statement, you have joined together what were company-approved practices, and situations where employees deviated from the Hutton corporate-approved policy and practice. There was nothing in the company-approved policy that led to the illegal charges.

Mr. HUGHES. I don't want to get bogged down on this point, because I think that as we go on, the point will be developed.

But, it seems to me that there was a great deal of pressure on those that were managing this money at the branch and regional level to take as much advantage of the "float" as they could, and if it meant drawing down the same day, not just those moneys, but also moneys that were not really legitimately generated by Hutton, just to have access to that money and the use of that money for a few days. And so, in that context, I gather that your concern is with the use of the term immediate.

Mr. FOMON. Yes.

Actually, I would rather Mr. Morley commented on your memo. You know, everything I've learned about cash concentration systems I've learned in the past 3 months. Prior to that, I didn't know what a cash concentration system was.

Mr. HUGHES. You probably know more about it than you want to right now.

Mr. FOMON. A little more than I used to.

Tom, would you comment on the memo?

Mr. MORLEY. In this context, the word immediate, you may assume that, when we deposit a check into the bank, we expect that check to be immediately available to us that day.

We understand that the check that we deposit into the local depository usually has a clearing cycle, and that clearing cycle is based upon the time it takes to present that check to the bank it is drawn on.

The word immediate could imply that, if we take all our customer deposits and deposit those checks into our local bank account, we would have immediately available funds in our local bank account that day.

We do not assume that——

Mr. HUGHES. I don't think that suggests that, Mr. Morley.

Mr. Morley. OK.

Mr. Hughes. What it suggests is that you were, as a matter of practice in these branches, depositing customers', and others', funds. Mostly customers' funds. And you were drawing down that same day.

Mr. Morley. That is correct.

Mr. Hughes. And that's pretty immediate. If you can find a better word, we'll correct it, but I think we understand the scenario, what we're talking about.

What other areas is it that you have some concern about?

Mr. Fomon. Tom.

Mr. Morley. The other area that we had some discussion or concern about was when we talked about the multiplier factors.

The multiplier factor is a factor where the intent to leave the bank with a sufficient balance over a period of time. We will adjust the daily deposits, and we will qualify the daily deposits, based upon the type of funds we are depositing into the local depository.

For example, a wire transfer is same-day funds. Right, it's immediate, where a check that we deposit we would expect to get one-day—so in the time span, usually its a month, to get an account analysis. In that time span, there may be a peak and valley, or a high and low, where we have excess available funds at the bank one day, and the next day we may not have a, it may be a negative available funds the next day at the bank. But always, or over the time frame of the month, quarter, whatever the agreement is with the bank, the balance that we have in the bank should be sufficient to cover our service requirements, and those service requirements are the same ones that most corporate Americans—check writing, wire transfers, things of that nature.

All the multiplier effect does, or attempts to do, is to qualify the time the bank has the money that is in excess of our service requirements.

And I think its worth noting that it works both ways. If we issue a local check, we will deposit excess funds into the bank, because we assume that that check will be cleared that day, even though it may not be. But the multiplier effect used in the approved draw down system is intended to get to the bank the balance level that we feel is necessary to support our services.

Mr. Hughes. I understand.

And I understand, without passing judgment on whether its, you know, a good practice or a bad practice. I understand that what you were trying to do was to try to ensure that the bank was making more than what you perceived to be a reasonable amount on the float. The fact that many of the deposits were cash, wire transfers, and were other instruments which were equivalent to cash, such as deposits in the depository institution of checks for a customer that was drawn on that particular bank, which in effect should be cash, there shouldn't be any delay.

I understand that. But the point I made in the statement was that the multiplier effect was then multiplied. What was happening was the regional offices were then drawing down two times what in fact had been drawn down by the branch bank. And quite often, if checking with the bank, it was determined that there was a balance at the branch bank, then another check was drawn to draw down again, a second time.

Mr. **Morley**. May I comment on that?

Mr. **Hughes**. Am I incorrect in that?

Mr. **Morley**. Well, I think we might be—you might be—but I just want to make sure I understand what we're talking about.

The concentration system that we had is a branch into a concentration bank. A concentration bank is usually in the region where the branch is located.

The local branch office would go through the daily worksheet that we're talking about here. It would apply the multiplier effect to the branch deposits, so if a customer wired in $1,000 to us, and that was the only activity for that day, the worksheet would say "draw down $2,000."

That would be communicated to the concentration bank, and the concentration, the regional concentration office would deposit to a DTC, which is a check, into our regional concentration, $2,000. The same thing would be done, that step would be duplicated on the regional level, or the concentration level, to corporate, to banks that you refer to in New York or in Los Angeles.

So there would be no doubling-up along the line. $2,000 would be taken from the local branch and moved into our second tier, the regional level. Then that $2,000 would be taken out of that regional level and moved into one of our corporate accounts, where it would be used on a daily basis.

Mr. **Hughes**. I understand. Of course, none of this was done with the banks' knowledge or consent.

Mr. **Morley**. Well, the, when you say "with the banks' knowledge," the concentration bank——

Mr. **Hughes**. No, no, I'm talking about the branch banks.

Mr. **Morley**. Without their knowledge or consent?

Mr. **Hughes**. That is correct.

Mr. **Morley**. Well, I don't know that we can say that. Certainly we have attempted to inform the bank, and I have encouraged people to speak to the banks so they know how the system will work, and they understand it.

Mr. **Hughes**. We'll get into this. I think we're a little ahead of ourselves.

I understand the point you're trying to make. I'm not sure that I quite agree, and I think we have some questions that we'll more vividly bring out; in fact, we understand the point that you're trying to make, we just may disagree as to the knowledge and consent aspect, as well as some of the practices which we've picked up from the documents.

But, rather than prolong this particular discussion, the point you make is that you had a, what you considered to be a, sound business practice relative to the multiplier effect, and that was to take into account some of the negotiable nature of the deposits, the cash and other deposits, that were made which gave you the right to in fact take advantage of the float, because they were there, they were collected funds.

I understand that.

Mr. **Fomon**. That E.F. Hutton has a policy of acting fairly in all of its commercial dealings. We certainly expected the banks to be fairly compensated for their services.

That system broke down for a number of reasons, and branches in regions violated that policy.

Mr. **Hughes**. OK. Thank you very much.

Mr. Fomon, we have your opening statement, which I presume you are prepared to make at this point, and, without objection, your statement will be put in the record in full, and that includes the overview that you have of your statement, and you may proceed as you see fit.

Mr. **Fomon**. Well, I would propose that we dispense with the reading of my statement. I understand that the committee has a lot of questions, and I am ready for questions.

I would like to read two short paragraphs, which might help to put this whole situation in perspective.

At one point I saw in the press that Hutton had received an aggregate amount as high as $10 billion in what were, in effect, interest-free day loans through these activities. I have also seen figures of $1 billion. The Justice Department, in the plea agreement, stated that it was in excess of $1 billion. I saw another figure of $4.38 billion.

We will not know the actual figure until the restitution process is completed, but for purpose of illustration, let us assume the $10 billion figure is accurate.

The $10 billion includes both legal and illegal activity, but again let us assume hypothetically that that entire $10 billion was illegally borrowed from the banks. Over the 20-month period that this took place, $10 billion equates to an average day loan of approximately $16,500,000. You put a high 20-percent interest factor on that amount, and there were only 3 months during that 20-month period where interest rates were as high as 20 percent, but if you put a high 20-percent interest figure on that amount, you would have E.F. Hutton gaining improperly $5½ million in illegal profits from our commercial banks during the 20-month period.

[The statement of Mr. Fomon follows:]

Testimony of Robert M. Fomon

Chairman and Chief Executive Officer
The E.F. Hutton Group Inc.
E.F. Hutton & Company Inc.

Before the

Subcommittee on Crime

of the

Committee on the Judiciary

of the

United States House of Representatives

June 19, 1985

Mr. Chairman, Members of the Subcommittee:

My name is Robert M. Fomon. I am the Chairman and Chief Executive Officer of The E.F. Hutton Group Inc. and its broker/dealer subsidiary, E.F. Hutton & Company Inc. With me today are Thomas P. Lynch, the Vice-Chairman of The Hutton Group, Michael Castellano, the Comptroller of The Hutton Group, and Thomas P. Morley, the Senior Vice President for Money Mobilization of the broker/dealer.

As the Subcommittee is aware, on May 2, 1985 the Hutton broker/dealer pleaded guilty in the federal district court in Scranton to an information charging mail and wire fraud through misuse of the float in Company checking accounts at commercial banks during the period July 1, 1980 to February 28, 1982.

The past two months have been a difficult and often frustrating period for the Company, its senior management, and particularly for our 17,000 employees. A great tragedy of this sorry affair is the unfair stigma attached to these 17,000 men and women -- people of the highest integrity and professionalism. Without minimizing the seriousness of what has occurred, let me attempt to place the practices to which we pleaded guilty in perspective.

First and foremost, the practices in question did not involve customer or client funds. Our most fundamental commitment as a company is to our customers and clients, and that commitment has not in any way been breached. The injured parties were some of the approximately 400 commercial bank where the Company maintained checking accounts over the 1980-1982 period. We will not know precisely how many banks were affected until the restitution process is complete, at which time we would be willing to provide that information to this Committee. But we are confident that the number of institutions involved is below the 400 number that has been publicly reported.

Second, when these practices came to the attention of senior management over three years ago, we issued directives to stop them. To my knowledge, those practices have not recurred. We have implemented on an ongoing basis since 1982 and are continuing to implement stringent controls to assure that the practices will not recur.

Third, the Company has established a restitution program to provide full and prompt compensation to any bank that was injured, including interest from the date the injury occurred. The mailings to start the restitution process went out to the banks last week -- well ahead of the Court-ordered schedule. The two million dollar fine and the restitution program will not have an adverse financial impact upon the Company in the future. The reserve we have established to cover these costs has already been reflected in the Company's published earnings.

While we strongly believe that the amount placed in reserve will be sufficient to cover the ultimate level of restitution, we will not know the exact amount of the damages to these banks until the restitution is complete. However, there have been figures reported in the media which we feel made some stupid and clearly improper banking activities on Hutton's part look even more extensive than they were.

At one point I saw in the press that Hutton had received an aggregate amount as high as 10 billion dollars in what were in effect interest free day loans through these activities. I have also seen figures of 1 billion dollars and 4.38 billion dollars. We will not know the actual figure until the restitution process is complete, but, for purposes of illustration, let us assume the 10 billion dollar figure is accurate.

That 10 billion figure includes both legal and illegal activity. But again, let us assume hypothetically that that entire 10 billion dollars was illegally borrowed from the banks. Over the twenty-month period this took place, 10 billion dollars equates to an average day loan of approximately $16,500,000. If you put a high 20% interest factor on that amount, you would have E.F. Hutton gaining improperly about $5,500,000 in illegal profits from our commercial banks during the twenty-month period.

Let me now turn to the plea and the public response to it. I will outline briefly the practices to which the Company pleaded. I will then discuss the matter of individual responsibility and address some of the questions that have been raised -- in the press and elsewhere -- concerning it.

As described in more detail in the appendix to this testimony, the violations arose out of abuses of the Company's system for collecting funds received by its domestic branch offices and transferring those funds to central accounts, where they are used to meet corporate cash needs. In general, the Company was charged with misusing the "float" that arises in the banking system in the interval between the time a check is deposited in a bank and the time that the depository bank collects funds from the bank on which the check was drawn. The two practices found illegal were:

- "excessive drawdowns" -- intentionally and persistently writing excessively large checks against deposits before the checks creating those deposits had cleared. The effect was to create interest-free loans from the banks to the Company.

- "multiple transfers" -- transferring funds successively through several banks on their way to the Company's central accounts in New York and Los Angeles, thus permitting the Company to benefit from potential increases in float that might arise from random delays in the check-clearing system.

The Government did not criminally challenge the Company's basic "cash concentration" system but rather the abuses -- excessive drawdowns and multiple transfers -- that developed in that system. In a companion civil action, however, the Company has been enjoined from using certain elements of its basic system without the consent of the banks involved. The Company is also specifically enjoined from using the two practices to which it pleaded guilty.

As we have previously publicly stated, when the first individual instance of multiple transfers came to the attention of management in December 1981, the Company offices involved were ordered to stop and did stop. When senior management later became aware that such practices might be more widespread, the Company issued directives that led to the permanent cessation of all such practices wherever they occurred.

We have identified 20 offices out of the firm's 300 then-existing domestic branches that may at some point in the 1980-1982 period have engaged in illegal excessive drawdown activity.

The multiple transfer practice, which involved previously undefined areas of the law, was more prevalent. We have identified 83 offices that engaged in this practice at some point during 1980-1982.

In view of the complexity of these transactions and limitations in then-existing management information systems, the above figures may not be definitive. The Company is confident, however, that those figures represent what is known today and are an accurate measure of the order of magnitude of what may have occurred.

Now let me turn to the issue of individual responsibility, which has attracted, to put it mildly, a great deal of public interest and concern. Somehow the fact that no individuals were indicted has been translated into a broader message that no one stands accountable. The reality is that the Company and its senior management, myself included, assume responsibility for what occurred. We assume responsibility because we stand accountable for activities undertaken in the firm's name and because the Company is responsible for failing to have imposed what in retrospect were needed controls on internal cash concentration procedures. Our controls were directed primarily at safeguarding our clients' funds and securities as well as assuring that we complied with the rules of our various regulatory bodies.

Anyone who suggests that there is no deterrent effect in punishing corporations without obtaining individual convictions has no idea what the real world is like. The investigations by our regulators, the massive amounts of time and effort being expended to comply with the injunction, the very real impact on our corporate reputation -- all of this has been felt not just as one shot on May 2 but day after day after day, by all our employees. I cannot believe that any corporate manager would willingly let himself or his company in for what we have been going through. Although we fully expect to reestablish our good name and to emerge from this experience the better for having undergone it, it has been a trauma that none of us will ever forget.

We have an obligation to assure that any individuals who deserve to be held accountable are held accountable. Whether the Justice Department believed there was sufficient cause to indict individuals is one issue. Whether individuals might have violated E.F. Hutton's own standards is a separate issue. We have an obligation to enforce our own standards, and we will do so.

Much has been debated about individual punishment. Many, including some of our own employees, feel that there must be a purge. If any of our clients had been injured, if we had breached any of our fiduciary responsibilities, if we had violated the securities or commodities laws, the decision would be easy. The people involved would be gone. But these things did not happen. After three years of investigation, the Justice Department concluded that no individuals should be indicted because of the difficulty in proving "criminal intent." In view of the obvious complexity of this case, I believe everyone deserves an opportunity to be heard. I intend to see that our inquiry is conducted fairly and as objectively as possible.

As you know, Judge Griffin Bell, former Attorney General of the United States, has agreed to serve as our special counsel and to conduct an independent inquiry into this entire matter.

Judge Bell's reputation for integrity and independence is beyond dispute. His inquiry will be objective and comprehensive. He has been charged with conducting a thorough review of the practices to which the Company pleaded guilty, determining how those practices evolved, identifying those individuals who bear personal responsibility, and making recommendations with respect to those individuals. We have made available to the Subcommittee copies of my letter retaining Judge Bell and his response, which together set forth the terms of his engagement. We have placed no constraints on him in terms of either time or scope, but I understand that he hopes to have completed his work by Labor Day.

In summation, I believe that E.F. Hutton has acted responsibly in response to this whole sorry affair. We stopped the activities when they were discovered; we cooperated fully with the Grand Jury, supplying them with six or seven million documents; we have paid our fine; we will make full restitution to the injured parties; and we have retained Judge Bell to conduct an independent inquiry.

E.F. Hutton is and always has been a responsible corporate citizen -- and we very much regret this unfortunate aberration in our distinguished 81 year history.

Thank you.

APPENDIX

to the

Testimony of Robert M. Fomon

Chairman and Chief Executive Officer
The E.F. Hutton Group Inc.
E.F. Hutton & Company Inc.

Before the

Subcommittee on Crime

of the

Committee on the Judiciary

of the

United States House of Representatives

June 19, 1985

__NOTE:__ This Appendix is dated as of May 2, 1985

I. OVERVIEW

Today E. F. Hutton & Company Inc., the broker/dealer subsidiary of The E. F. Hutton Group Inc., pleaded guilty to violation of the mail and wire fraud statutes with respect to the Company's handling of its domestic checking accounts at certain commercial banks during the period July 1, 1980 to February 28, 1982. No criminal charges were brought against The E.F. Hutton Group or against any individual. The charges were filed in Scranton in the United States District Court for the Middle District of Pennsylvania.

For 82 years, E. F. Hutton has been committed to setting and maintaining the highest standards of corporate conduct. The practices to which the Company has pleaded guilty represent a serious breach of those standards. For that breach, the Company and its top management assume full responsibility. The Company assumes responsibility because it stands accountable for activities undertaken in its name and because in this instance, the Company is responsible for failing to have imposed what in retrospect were needed controls in internal bank deposit concentration procedures. The fact that senior management stopped the practices in question when brought to their attention early in 1982 does not alter the Company's fundamental accountability.

This Company believes it has an obligation -- to its shareholders, clients, employees, and the public at large -- to explain as best we can what happened, why it happened, and what we have done about it. The purpose of this memorandum is to provide those details.

Without in any way minimizing the Company's responsibility or the seriousness of what has occurred, we believe it is important to place this event in its proper context.

- The practices to which the Company pleaded guilty, which ended in early 1982, did not involve or jeopardize customer or client funds, and the Company did not in any manner violate its fiduciary duty to its customers or clients. The Company's most fundamental commitment is to its customers and clients, and that commitment was not breached. The violations relate solely to the operation of the Company's own checking accounts at commercial banks, and the parties the Company is charged with having harmed are exclusively commercial banks. Likewise, the violations did not involve the Company's dealings with securities or commodities firms or the Company's investment banking operations. Nor did the Company fail to comply with the multitude of federal and state regulatory requirements to which it is subject.

- Without diminishing the Company's responsibility, the practices in question violated the Company's overall policies and philosophy. When the first individual instance of the practices subsequently found illegal came to the attention of management in December 1981, those practices were ordered by management to stop and were stopped. When senior management later became aware that those practices might have been more widespread, the Company began an internal investigation which led to the immediate curtailment of all those practices. In short, the practices in question were stopped as soon as senior management became aware of them and in the subsequent three years have not recurred.

- The Company has taken steps to assure that those practices will never recur in the future. In the period from February to May 1982, various communications were sent to regional and branch personnel clarifying and revising the details of existing cash concentration procedures. Those communications are described in greater detail in a subsequent section of this Memorandum. Arthur Young & Company, which is nationally recognized for its expertise on this subject, was brought in to review and recommend changes in the Company's practices in this area, and those recommendations were subsequently implemented. An extensive computer system is being installed which, among numerous other features, will automate branch cashier and drawdown functions, which will further enhance our ability to monitor practices on a branch and regional level.

- While the government's investigation was underway, the Company could not take personnel actions without compromising its own legal position and the legal position of employees called before the grand jury. With that inquiry now complete, the Company is in a position to take such individual personnel actions as are appropriate.

- The Company will provide full and prompt compensation to any bank that was injured. The Company has established a restitution program that will cover any losses, including subsequent interest, suffered by banks at which the Company had checking accounts in the 1980-1982 period. The ultimate level of restitution, because it includes interest on the banks' losses, will exceed the earnings which accrued to the Company through the illegal activities.

- The Company has agreed to pay a criminal fine of $2 million plus an additional $750,000 to defray the costs of the investigation by the Government. Under federal law, each mailing or use of the wires is a separate offense. To reach the agreed-upon fine of $2 million, the Company pleaded guilty to 2,000 counts of fraud because there is a maximum fine of $1,000 for each use of the mails or wires.

- Payment of the criminal fine and implementation the restitution program will not have an adverse financial impact upon the Company. In addition to reserving $2.75 million to cover the criminal fine and prosecution costs, the Company has established a reserve of $8 million to cover potentia restitution, including subsequent interest, to the banks. The costs of those reserves have already been reflected in the Company's published earnings and will not affect future earnings. The Company is confident that the restitution reserve will be more than adequate to cover restitution to the banks.

II. KEY ELEMENTS OF PLEA AGREEMENT

In a companion civil case, the Company consented to an injunction forbidding it from using certain banking practices or techniques without the prior consent of the banks involved. The Company is also prohibited from using the two practices to which it pleaded guilty.

The violations arose out of abuses of the Company's system for collecting funds received by its then-existing 300 domestic branch offices and transferring those funds to central "concentration accounts" where they are used to meet corporate cash needs. The Government is not challenging the legality of Hutton's basic system of collecting and moving funds from its branches to central locations; the violations stemmed from abuses of that system. Those abuses were halted when they came to the attention of senior management early in 1982.

In general, the Company was charged with misusing the "float" that arises in the banking system in the interval between the time a check is deposited in a bank and the time that the depository bank collects those funds from the bank on which the check was drawn. Specifically, the acts to which the Company has pleaded guilty were:

- "excessive drawdowns" -- intentionally and persistently withdrawing, or "drawing down," bank deposits in excess of the amount called for by Hutton's formula before the checks creating those deposits had cleared. Excessive drawdowns permitted the Company, in effect, to obtain interest-free loans.

- "multiple transfers" -- transferring funds successively through several banks on their way to the Company's central concentration accounts in New York and Los Angeles, hoping to benefit from potential increases in the float that might arise from random delays in the check clearing system.

The Government's document notes, and the Company agrees, that the Company's aggregate drawings against uncollected balances for the 20-month period exceeded well ove $1 billion. This does not mean that there was ever $1 billion of such drawings at one time, but that the sum of the individual daily drawings against uncollected balances exceeded $1 billion over the 20-month period. More important, this aggregate figure includes legal activity as well as drawdowns involving the practices to which the Company has pleaded guilty. Drawings against uncollected balances are a common and accepted practice among corporate depositors; it is only when such drawings become "excessive" on an average daily basis that they become improper.

For example, if for illustrative purposes we assume that over the 20-month period there were 600 days on which the Company drew against uncollected balances of $3 million per day, that activity would produce a sum of $1.8 billion (600 days x $3 million).

Scope of Illegal Practices

On the basis of an internal inquiry, the Company has identified 20 offices out of the firm's 300 then-existing domestic branches which may at some point have engaged in intentional excessive drawdowns. In some but by no means all instances, the character of those transactions was ambiguous, and thus the figure of 20 may include offices that engaged in drawdown practices that were not culpable. For purposes of this disclosure, the Company is classifying all transactions that were at least "questionable" as excessive.

The multiple transfer practice, which involved previously undefined areas of the law, was more prevalent. The Company has identified 83 offices that engaged in this practice at some point during the 1980-1982 period.

In view of the complexity of these transactions and limitations in then-existing management information systems, the Company's data on the number offices which might have engaged in these practices may not be definitive. However, we are confident that the figures provided above represent an accurate measure of the order of magnitude of such practices, and, in any event, any modification of the final figure would not impugn the adequacy of the published reserve.

While the Company believes it important to disclose the scale and extent of these practices, the Company is not identifying the particular offices involved. That decision reflects several considerations. First, we believe it is clear that the practices were terminated three years ago when they came to the attention of senior management, and the Government has not charged that such practices subsequently recurred. Second, the Company has pleaded guilty and is offering full restitution to any injured parties. Under the circumstances, we believe it would be unfair to identify Hutton employees who were carrying out practices that they did not believe were illegal or violative of Company policy. With respect to the number of individual commercial banks that might have been injured, the Company will not be in a position to determine precisely how many banks suffered injury until the claims have been received and evaluated.

III. HUTTON'S CASH CONCENTRATION SYSTEM

Introduction

The purpose of Hutton's cash concentration system is to move funds from its local branches as quickly as possible to central accounts in either New York or Los Angeles where the Company can use the funds. The system calls for the money to move from local banks where Hutton's branches are located to banks in Hutton's regional headquarters cities and then to the central accounts.

Hutton's policy has been that its banks should retain -- on average but not necessarily on any particular day -- enough collected funds to adequately compensate the banks for their services. At the same time, Hutton does not wish to leave additional funds in the banks since that would deprive the Company of the use of its own money. Between July 1, 1980 and February 28, 1982, however, Hutton drew against a number of its accounts to a greater extent than the banks expected, with the result that those accounts were in uncollected positions and the banks were in effect making interest-free loans to the Company.

The Hutton System

The system described here is legal; a later section describes improper variations.

The device Hutton uses to move its funds from local to regional and finally national bank accounts is called a depository transfer check (DTC). These are checks drawn on a Hutton account in one bank and deposited in another. Each day, the Hutton local branch cashier takes the amount deposited that day in the local bank and, applying an approved formula, informs the regional cashier of the amount to be drawn down; the regional cashier then draws a DTC for that amount on the local bank account and deposits the DTC in the regional bank. Later the same day a similar process occurs between the regional cashiers and the national cash desk. This process in effect moves funds from local branches through the banking system to Hutton's central accounts overnight. The formula is designed to leave certain amounts of collected funds (on average) on deposit in local and regional banks to compensate them for their services.

There are two circumstances when a Hutton regional office may write a DTC for more than the amount deposited that day in the local bank. Hutton does this to maintain its average collected balance at the level deemed appropriate to compensate the bank.

Immediately available funds. One circumstance involves immediately available funds. Hutton's daily deposits in local banks regularly include cash, wire deposits and checks written on the same bank in which Hutton has an account. These funds are available to Hutton on the same day they are deposited. They do not need to be collected by the local bank from another bank. Leaving these funds on deposit in the local bank until they are transferred the next day when the DTC clears allows the bank an extra day's use of the funds.

Therefore, Hutton developed a formula which allows for DTCs to be written in excess of the amount actually deposited that day, thus reducing the average collected balance in the account and bringing bank compensation closer to the targeted level. The system adjusts itself each day, making up for excesses or deficiencies in the amount on deposit.

The float. The second circumstance involves the "float." As used here this is the difference between the time a check is *scheduled* to clear and the time it *actually* clears. Many checks clear between banks within one day, either through the Federal Reserve System, correspondent bank networks or local bank clearing houses. The Federal Reserve System is committed to clearing all checks within two days.

Sometimes, because of weather or mechanical failure, checks take longer to clear then they are scheduled to. There is a "float." If a Hutton DTC does not clear when scheduled that means Hutton's money stayed in the local bank an extra day or longer, and the local bank benefitted from the extended use of Hutton's money.

Hutton believes it is entitled to share in the float on its own checks. Therefore, it created a mechanism to "recapture" the float when its DTCs failed to clear on time. As with the correction for immediately available funds, DTCs are increased so that the *average* local bank balance would be adjusted downward to meet the target average balance.

Preventing overdrafts. In either event, should it appear in writing increased DTCs that an overdraft might result (*i.e.*, that a check might be presented to a bank without funds on deposit to cover it), Hutton corrects the situation by depositing one of its own checks (a "branch reimbursement check") drawn on a special bank account in New York. Thus, Hutton does not attempt to draw out of the bank more than has been deposited there.

The operation of Hutton's drawdown system is described in greater detail in the Appendix.

The Illegal Practices

The Government has not brought criminal charges involving the basic operation of E. F. Hutton's cash concentration (or "drawdown") system described above. The Government has asserted that Hutton should have announced to its banks how its drawdown system operated including, in particular, the fact that the system was designed to draw against uncollected funds when necessary to adjust bank compensation. The Government has not charged that the failure to make such announcements, by itself, constituted criminal conduct. It was and is Company policy that the banks with which it deals should be informed of the general nature of the transactions the Company intends to undertake, although adherence to this policy in the July 1980-February 1982 time frame was inconsistent. Pursuant to the terms of the civil injunction Hutton will be forbidden from engaging in a number of practices in the area of collected balance management -- including, in particular, intentionally drawing on uncollected funds -- without prior written agreement or consent of the bank involved.

The two practices which the Government has, however, charged and to which Hutton has pleaded guilty are described below.

(A) Excessive Drawdowns

In a number of instances Hutton personnel caused DTCs to be issued in arbitrary amounts far in excess of those called for by the drawdown formula and covered those large DTCs the next day by depositing Hutton "branch reimbursement checks" into the affected branch accounts. This procedure caused the branch's bank to be persistently uncollected on an average ongoing basis, thereby resulting in, in effect, the bank's extension of an interest-free loan to Hutton. Had the local bank been monitoring the account and charging Hutton for its use of uncollected funds (as most banks do and all banks should do), the bank would not have suffered any loss. In any event, the restitution program established pursuant to the plea agreement will ensure that no injured bank will go uncompensated.

(B) Multiple Transfers

The basic cash concentration system described abov was vertical -- branch to region to national concentration account. In some instances during the July 1980 - February 198 time period covered by the Government's charges, however, the branch-to-region-to-headquarters system was altered so that branches drew down other branches before themselves being dra down by their regions. Thus, instead of Branch A and Branch both being drawn down by their region in the amounts of, say, $100 and $200, Branch B would draw down Branch A in the amoun of $100 and the region would then draw down Branch B in the combined amount of $300.

The purpose of such branch-to-branch transfers, or "multiple transfers", was in many instances to increase and then recapture float caused by clearing delays. If all checks clear in one day, the entire $300 drawdown in the previous example will travel through the system to the national concentration account the day after deposit and, indeed, there will be no difference in effect between the original "vertical" drawdown and the "multiple transfers" just described. But checks do not always clear when they are supposed to, and the multiple transfers increased the potential benefit to Hutton when clearing delays occurred. Although the number of checks in the system does not increase under multiple transfers -- there is still one DTC per branch per day -- the average size of the DTCs increases; in our example, the Branch A DTC is still $100, but the Branch B DTC is now $300 instead of $200. If the Branch A DTC "floats" for a day there is no additional benefit, but if the Branch B DTC "floats", the benefit to the local bank (which Hutton will then "recapture") will be $300 instead of $200. Even if clearing delays are random events, therefore, the increased size of the DTCs in the system increases the average expected float benefit to Hutton, and some locations may well have been selected with an eye toward increasing the likelihood that checks would fail to clear on schedule. Although there were often legitimate business reasons for branch-to-branch transfers,[1] in many cases a principal

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[1] These reasons included:

a) Administrative convenience. From time to time DTCs of several branches would be deposited in another branch, which would then be drawn down by the region, thus decreasing the administrative load on the regional cashier. With numerous telephone calls or wires transmitting drawdown information arriving in a brief time period each afternoon, it was a considerable burden for a regional cashier to receive the information, process it, and issue drawdown checks for all the branches in a region every day. The burden was reduced (by being spread around) when some branches concentrated the funds of several other branches before being drawn down by a regional office.

b) Speeding up availability. Sometimes the Company

(Footnote continued on next page)

reason was a desire to find and take advantage of this sort of "float", especially toward the end of 1981 when interest rates rose.

In theory, multiple transfers should not injure the banks. They are the initial beneficiaries of float, and the Hutton drawdown system recaptured less than all of the float, so the banks may actually benefit to some extent from this activity. For several reasons, however, which are related to availability, some banks may have been hurt in practice.

(Footnote continued from preceding page)

could get better availability on DTCs by taking several small steps rather than one large one. Regional concentration banks might give one-day availability on major banks in neighboring states, but not on smaller banks there, whereas the neighbor-state major banks _would_ give one-day availability on the smaller banks. It made sense, therefore, to draw down the smaller banks into the major banks in their own state, which would then be drawn into the regional accounts, so _all_ deposits would reach the region in the desired one day.

c) _Slowing down clearing_. In a few cases, because of local peculiarities, DTCs were clearing on the day of deposit. These DTCs thus cleared a day before the customer checks that had been deposited in the branch bank became collected, so the banks of branches whose DTCs cleared on a same-day basis were consistently uncollected. To solve this problem without having to modify the entire drawdown calculation for such branches, the affected branches were drawn down by locations other than their own region's concentration account.

d) _Satellite branch offices_ (_i.e_., branch offices geographically close and administratively subordinate to other offices) were frequently drawn down through their main branch.

First, a bank may have assumed that the deposit mix of the Hutton branch consisted almost entirely of customer checks drawn on nearby banks. If, however, a Hutton branch also includes in its deposit a check from another Hutton branch drawn on a bank outside its immediate environs, the branch's bank may not be able to obtain one-day scheduled collection on these checks. If the bank does not realize this, it will be persistently uncollected.[2] Moreover, the Hutton drawdown system -- which assumes one-day availability throughout -- will treat the two-day clearing as float to be recaptured, thereby causing the DTCs to grow larger and increasing the injury to the banks.[3]

Second, increased float results in increased recapture, which in turn results in increased use of branch reimbursement checks (BRCs). The Hutton drawdown system assumes that these BRCs are always given one-day availability. This is a reasonable general assumption, since the BRCs are drawn on major New York banks, and New York is a one-day point from mos of the United States, but the assumption is not universally true. When there is not much float, BRCs are generally small and infrequent and erroneous assumptions as to availability ar unlikely to matter much in the long run. As float increases, however, this may no longer be true, and the potential for injury to the banks increases.

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[2] The civil injunction in this case accordingly requires disclosure to and agreement by a bank before it may be used as a concentration point.

[3] The DTCs can also grow larger if float occurs over a weekend. Because most banks are closed on Saturday and Sunday, Friday's closing collected balance has a triple effect on the ongoing average, for it is Saturday's and Sunday's as well. The Hutton drawdown system takes this into account by increasing the DTC adjustment factors where weekends are involved.

There was also a third way in which some banks could have been injured by multiple transfers. Some branches combined multiple transfers with excessive drawdowns -- that is, instead of simply adding the incoming DTC to the outgoing one, these branches added more. This resulted in increasing the uncollected balances.

IV. HOW DID IT HAPPEN?

Neither the multiple transfers that were engaged in solely to benefit from float nor the excessive drawdowns were sanctioned Company policy. Both practices became more extensive in late 1981 in response to rising interest rates, and as knowledge about these practices spread. As is common in the industry, the compensation of Hutton branch managers is tied partially to the profitability of their offices, and one of the elements in determining profitability is interest income. During the period of rising interest rates in 1980 and 1981, there was particular sensitivity to the importance of interest income. It appears that in some instances one of the responses on the branch and regional level to incentives to take maximum advantage of all the float in the system was to take advantage of float that was not there.

The Company and its auditors did not detect these deviations because the Company's internal controls were geared towards assuring compliance with the numerous state, federal, and internal regulations that safeguard customer accounts. Those controls have always worked and continue to work well. In retrospect, however, the Company could and should have kept a tighter rein on its internal banking practices to keep them from crossing the dividing line between aggressive and improper.

V. HUTTON'S RESPONSE AND THE FUTURE

Uncovering the Wrongdoing

Multiple transfers came to the attention of senior menagement as a result of a series of events in late 1981. A multiple transfer of funds in the Middle District of Pennsylvania came to management's attention in December 198 when it collapsed under its own weight.[4] This multiple

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[4] This Pennsylvania/New York multiple transfer activity functioned for only 6 days in the first half of December

(Footnote continued on next page)

transfer activity was immediately shut down. In February 1982, when senior management became concerned that the problem might be more widespread, it initiated an internal investigation, which discovered the existence of other multiple transfer systems. Firm steps described below were taken to shut them down and to prevent their recurrence.

(Footnote continued from preceding page)

1981. Hutton's Wilkes-Barre branch drew down three New York area branches and was itself drawn down by Batavia, New York. Batavia and Strafford, Pennsylvania were drawn down by Fortieth Street (in New York City), which was drawn down by the Atlantic Region concentration account in Rochester.

This multiple transfer was dismantled immediately after an incident on December 11, involving Genesee Country Bank in Batavia, an incident that was symptomatic of a problem that appeared as soon as multiple transfers were started: some of the small banks involved were unable to handle the larger items that were sent through the Company accounts. On Friday, December 11, 1981, Genesee was presented with a large DTC that had been deposited in Republic Bank (the account used by the Fortieth Street branch in New York City). Genesee had Company checks drawn on United Penn Bank in Wilkes-Barre, and it called United Penn to ask whether United Penn had collected funds of $8,000,000 in the Company account. It did not. United Penn did, however, have uncollected funds, represented mainly by Hutton branch reimbursement checks that had been deposited the day before. Genesee thereupon dishonored the DTC presented by Republic, and both Genesee and United Penn subsequently dishonored several other DTCs. Upon learning of these actions, Hutton immediately wired federal funds into both banks -- $20,000,000 to Genesee Country Bank, and $18,800,000 to United Penn. The bank then closed the Company's account.

Some of the excessive drawdowns came to light at about the same time, and persons participating in them were directed to stop. Other excessive drawdowns that had occurred were uncovered as the Government's and Hutton's investigations progressed, but there is no indication of such practices having taken place after February 1982; the controls described below were designed to stop all multiple transfers and all excessive drawdowns.

Corrective Measures

On February 22, 1982, wires were sent to the Regional Vice-Presidents and Operations Managers instructing them where their branches were to be drawn down. The wires required positive acknowledgement by the recipients. Unauthorized branch-to-branch transfers have not occurred since the first quarter of 1982.

On May 17, 1982 the Company directed all branch and regional personnel to discontinue making adjustments for "on us" and other good funds deposits and to merely draw the branch checkbooks to zero at the end of each day (*i.e.*, proceed according to Table I above). Nationally recognized cash management specialists at the Big Eight accounting firm of Arthur Young & Company were retained to review the branch drawdown procedure and consult with the Company about potential adjustments and/or improvements. As a result of these consultations the DTC calculation procedure was revised in July to eliminate some of the ambiguities in the old procedure and to spell out in a less confusing fashion precisely how the drawdown was to be computed each day.[5] A few months later the procedure was revised again to implement Arthur Young's suggestion that some aspects of the concentration system could make use of wire transfers.

The Company is currently in the process of installing a Branch Information Processing System ("BIPS") in New York and in the Company's 400 branches, at a cost of $42 million. An automated drawdown system is a priority procedure for BIPS and is currently scheduled to be implemented in 75-100 branches that are expected to be on line shortly. This system will serve a great number of functions and will automate branch cashier functions, branch drawdown, and new accounts processing. The system will curb calculation errors and, more in terms of the issues raised in this case, is designed to allow New York to monitor drawdown activity at the branch and regional levels. By automating the drawdown process, BIPS will completely eliminate any faint residual possibility that multiple transfers or excessive drawdowns -- which have not occurred since early 1982 -- could somehow crop up again.

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[5] The Company believes that some of the excessive drawdowns may have begun as a result of calculation mistakes that then became less and less inadvertent.

In addition to these controls, the Company is required by its plea agreement and by the civil injunction to institute certain additional precautionary measures, including instructional seminars to employees and special controls by internal and outside auditors.

APPENDIX

The E. F. Hutton Cash Concentration System

E. F. Hutton is a large, geographically dispersed company, with some 400 branches throughout the United States. There were 300 offices at year end 1981. Each day those branches receive funds, generally in the form of checks, which the Company cannot in turn use effectively -- to pay customers and reduce borrowings -- until the funds are concentrated into centralized accounts in major money-center banks. One aspect of the Company's cash concentration system, therefore, is designed to transfer funds as quickly and efficiently as possible from its branch banks to regional banks and from there to two central accounts, one in New York and one in Los Angeles. While it is in Hutton's interest to transfer the funds quickly, it is in a bank's interest to hold onto the funds as long as possible. Banks earn money -- both as compensation for deposit services and as additional profit -- by investing funds customers leave on deposit with them; the longer the money is left on deposit, the more the bank earns. And because banks do not pay interest on commercial deposits, any time a commercial customer leaves more funds in its account than are necessary to pay for services rendered by the bank, it has given too much to the bank.

Before a bank can invest customer funds, however, those funds must be "collected" -- that is, they must represent actual cash available to the bank and not merely a check that will be, but has not been, collected from another bank. Banks generally keep track of two balances for each account -- the "ledger" balance, which reflects the actual amount of deposits and withdrawals, and the "collected" (or "available") balance, which reflects only those deposited items that have cleared any necessary process of collection. Banks can and often do permit corporate customers to use funds that have not yet been collected, but they charge customers for this service, either by direct fee assessment or by a request that the customer leave additional collected funds on deposit for a period of time to make up for the period in which its collected balance was in deficit.

The function of Hutton's cash concentration system is to move collected balances from outlying locations to centralized corporate concentration accounts, leaving -- on average but not necessarily on any particular day -- sufficient collected balances in the local banks to compensate them for their services to the Company, while avoiding leaving balances so large that the banks receive excess compensation. Generally, Hutton's system works satisfactorily. During the period between July 1, 1980 and February 28, 1982, however, the system was abused and Hutton drew against uncollected balances to a greater extent than certain of its banks expected. The result was that these banks not only were not compensated but, in effect, made interest-free loans to Hutton.

Hutton's approximately 400 domestic branches are organized into nine regions for administrative purposes. Historically, the regions have also served as intermediate cash concentration points between the branches and the main national concentration accounts in Los Angeles and New York.

The two principal cash concentration techniques in use in the United States today are wire transfers and depository transfer checks. Wire transfers, while quick and efficient, are also very costly and can only be used during a portion of the business day. The principal alternative, "depository transfer checks," or DTCs, was the technique used by Hutton. DTCs are checks drawn on one company account and deposited in another. Depository transfer checks from all the branches in a given region were deposited into the region's concentration accounts, and depository transfer checks from all the regional accounts were deposited in one of the two national concentration accounts. Like all checks, the DTCs must clear through the banking system before the funds they represent become collected at the bank in which they are deposited. This process often takes a day or more, with the result that the Company's funds may remain on deposit in the local banks for that period.

In the simplest possible scenario all customers would pay by checks drawn on other banks, and the branches would inform the regional cashier each afternoon of the amount of the day's total deposit at the branch.[6] The regional cashier would then deposit into the regional concentration account a DTC drawn on each branch's bank in the amount of that branch's deposit. Later the same afternoon, the regions in turn would inform Hutton's national cash desk of their total DTC deposit, and DTCs on the regional banks would be deposited into a national account. The next day, all of the customer checks would become collected in the branch banks, just in time to cover the branch DTCs being presented for payment; all of the branch DTCs would become collected in the regional banks in time to cover the regional DTCs; and all of the regional DTCs would become collected in the national concentration account to be used for corporate purposes. The funds would, in effect, flow from the customers' accounts to the national account in a single day. All balances would be drawn out the day they became collected, so Hutton's banks would not have had use of Hutton's funds overnight.

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[6] The accounts in question were used to collect receipts. Payments to customers were generally made out of other, centrally located accounts.

(1) The Effect of "On Us" Checks

The world is not so simple, however. Local Hutton branch deposits may contain cash or wire transfers or, more often, contain a significant portion of customer checks that are written on an account in the same bank as Hutton uses ("on us" checks) and thus do not need to be collected through the banking system. All these items are treated as collected (and thus available to the depositor) immediately on deposit. If all that Hutton did was to deposit DTCs in its regional accounts equal to the amount of its deposits in branch accounts, and those deposits contained (as they normally do) a significant portion of "on us" checks, the effect would be to give branch banks the full use of the funds represented by the "on us" checks until the next day, when the DTC cleared. Those funds however, are Hutton's funds, and it has been -- and is -- Hutton's position that while it pays banks for services rendered, it is otherwise entitled to the benefit derived from the use of its money.

To redress this imbalance, each Hutton branch each day kept track of deposits of cash, "on us" checks and other immediately available funds. Using a formula, the branch calculated a DTC in an amount potentially larger than the actual amount of customer deposits for that day, with the excess related to the proportion of local deposits consisting of immediately available funds. The formula also takes into account a targeted extra amount of collected funds that the Company seeks to keep on deposit to compensate the bank for its services.

For example, if $30 of a branch's $100 deposit consisted of "on us" checks or other immediately available funds, but only $10 in collected funds was needed to compensate the bank for its services, the Hutton branch's DTC for that day would not be $100 (the amount of the total deposit), but rather $120. The bank's collected balance tonight would be $30 -- i.e., $20 too much -- but this will be taken care of tomorrow when the DTC is presented for payment: the $20 added to the DTC will ensure that tomorrow's collected balance will be $20 lower than it would otherwise have been. The system proceeds day by day, adjusting tomorrow's collected balance to make up for today's excess or deficit.

Writing a DTC for more than the amount deposited raises the issue of whether there will be funds on deposit to cover the DTC when it is presented for payment the next day. In most instances the day 2 customer deposits will be sufficient to cover the day 1 DTC when it is presented; if those deposits are not sufficient, however, Hutton deposits one of its own checks drawn on a special bank account in New York into the branch is account. The checks used for this purpose were known as "branch reimbursement checks" or "BRCs." Writing a DTC in excess of the day's total deposit may well result in drawing on uncollected funds in order to compensate for a previous excess collected balance, but the BRC mechanism ensures that (clerical errors aside) there will never be an "overdraft", i.e., Hutton will not attempt to draw out of a bank more than has actually been deposited there.

Thus, suppose a Hutton branch takes in $100,000 a day in customer receipts, consisting of $25,000 in wire transfers and "on us" checks and $75,000 in checks written on other banks. Suppose further that an average daily collected balance of $10,000 is considered necessary to compensate the bank for its services, and suppose finally that all checks (other than the immediately available "on us" checks) clear in one day. Then the Hutton branch's account at its bank would show a total deposit on Monday of $100,000, of which $25,000 would be treated as "collected." The remaining $75,000 would not be treated as collected until Tuesday, when the checks constituting that portion of the deposit would clear. Similarly, $25,000 of the branch's $100,000 Tuesday deposit will be treated as collected on Tuesday and $75,000 as collected on Wednesday, and so on throughout the week.

In the simplest form of DTC concentration system, Hutton would each day write a DTC on the branch's account in the amount of the day's total deposit at the branch (here, $100,000 each day) and deposit that DTC in one of its concentration accounts. The DTC would clear through the banking system and be presented for payment to the branch's bank the next day. This would effect the transfer of funds from the branch's account to the concentration account, as set forth in Table I.

From Hutton's point of view, the problem with this simple system is that although funds are transferred efficiently the local bank is being overcompensated for its services. That is, the collected balance at the local bank is $25,000 each night, which is $15,000 more than needed to compensate the bank. The bank, in short, is making excess profits with Hutton's money. To prevent this, the Hutton concentration system was designed to adjust the amount of each day's DTC to reflect that day's immediately available deposits and thereby come closer to targeted bank compensation. Using this example, a DTC of $115,000 would be written and deposited in the concentration account on the first night ($100,000 thereafter) in order to leave that bank $10,000 in cash each night. The way the system would have worked in practice on the facts of the example in Table I is shown in Table II.

Table I

Activity	Bank Balances ($000)			
	Branch Account		Concentration Account	
	Ledger	Collected	Ledger	Collected
Monday				
Opening Balance	0	0	0	0
Customer Deposits	100	25	0	0
Monday's DTC	0	0	100	0
Closing balance	100	25	100	0
(Overnight, all Monday checks become collected)		75		100
		100		100
Tuesday				
Opening Balance	100	100	100	100
Customer Deposits	100	25	0	0
Monday's DTC clears	(100)	(100)	0	0
Tuesday's DTC	0	0	100	0
Closing Balance	100	25	200	100
(Overnight, all Tuesday checks become collected)		75		100
		100		200
Wednesday				
Opening Balance	100	100	200	200
Customer Deposits	100	25	0	0
Tuesday's DTC clears	(100)	(100)	0	0
Wednesday's DTC	0	0	100	0
Closing Balance	100	25	300	200
(Overnight, all Wednesday checks become collected)		75		100
		100		300
Thursday				
Opening Balance	100	100	300	300
Customer Deposits	100	25	0	0
Wednesday's DTC clears	(100)	(100)	0	0
Thursday's DTC	0	0	100	0
Closing Balance	100	25	400	300

Table II

	Bank Balances ($000)			
	Branch Account		Concentration Account	
Activity	Ledger	Collected	Ledger	Collected
Monday				
Opening Balance	0	0	0	0
Customer Deposits	100	25	0	0
Monday's DTC	0	0	115	0
Closing balance	100	25	115	0
(Overnight, all Monday checks become collected)		75		115
		100		115
Tuesday				
Opening Balance	100	100	115	115
Customer Deposits	100	25	0	0
Monday's DTC clears	(115)	(115)	0	0
Tuesday's DTC	0	0	100	0
Closing Balance	85	10	215	115
(Overnight, all Tuesday checks become collected)		75		100
		85		215
Wednesday				
Opening Balance	85	85	215	215
Customer Deposits	100	25	0	0
Tuesday's DTC clears	(100)	(100)	0	0
Wednesday's DTC	0	0	100	0
Closing Balance	85	10	315	215
(Overnight, all Wednesday checks become collected)		75		100
		85		315
Thursday				
Opening Balance	85	85	315	315
Customer Deposits	100	25	0	0
Wednesday's DTC clears	(100)	(100)	0	0
Thursday's DTC	0	0	100	0
Closing Balance	85	10	415	315

As Table II shows, the adjustment to the Monday DTC is sufficient to reduce closing collected balances (after the first day) to the targeted level of $10,000. The adjustment may very well result in Hutton's drawing on uncollected funds. For example, in Table II, if none of the Tuesday customer deposit consisted of immediately available funds, then the closing collected balance at the local bank would not be plus $10,000 but would instead be minus $15,000. The results for the entire week would then be as given in Table III. In Table III, the average closing collected balance (after Monday) is plus $10,000; Wednesday's balance of plus $35,000 makes up for Tuesday's $15,000 deficit. Table IV shows the result if there were no customer deposits at all on Tuesday, in which case a Hutton check (a branch reimbursement check, or "BRC") would have to be deposited in the branch account to prevent Monday's DTC from causing an overdraft. Once again, the average closing collected balance for Tuesday, Wednesday and Thursday is plus $10,000, although the actual balance on any one day varied.

Table III

Activity	Bank Balances ($000) Branch Account Ledger	 Collected	 Concentration Account Ledger	 Collected
Monday				
Opening Balance	0	0	0	0
Customer Deposits	100	25	0	0
Monday's DTC	0	0	115	0
Closing balance	100	25	115	0
(Overnight, all Monday checks become collected)		75 100		115 115
Tuesday				
Opening Balance	100	100	115	115
Customer Deposits	100	0	0	0
Monday's DTC clears	(115)	(115)	0	0
Tuesday's DTC	0	0	75	0
Closing Balance	85	(15)	190	115
(Overnight, all Tuesday checks become collected)		100 85		75 190
Wednesday				
Opening Balance	85	85	190	190
Customer Deposits	100	25	0	0
Tuesday's DTC clears	(75)	(75)	0	0
Wednesday's DTC	0	0	125	0
Closing Balance	110	35	315	190
(Overnight, all Wednesday checks become collected)		75 110		125 315
Thursday				
Opening Balance	110	110	315	315
Customer Deposits	100	25	0	0
Wednesday's DTC clears	(125)	(125)	0	0
Thursday's DTC	0	0	100	0
Closing Balance	85	10	415	315

Table IV

Activity	Bank Balances ($000) Branch Account Ledger	 Branch Account Collected	 Concentration Account Ledger	 Concentration Account Collected
Monday				
Opening Balance	0	0	0	0
Customer Deposits	100	25	0	0
Monday's DTC	0	0	115	0
Closing balance	100	25	115	0
(Overnight, all Monday checks become collected)		75 100		115 115
Tuesday				
Opening Balance	100	100	115	115
Customer Deposits	0	0	0	0
Hutton Check (BRC)	15	0	0	0
Monday's DTC clears	(115)	(115)	0	0
Tuesday's DTC	0	0	0	0
Closing Balance	0	(15)	115	115
(Overnight, all Tuesday checks become collected)		15 0		
Wednesday				
Opening Balance	0	0	115	115
Customer Deposits	100	25	0	0
Tuesday's BRC clears	0	0	(15)*	(15)*
Tuesday's DTC clears	0	0	0	0
Wednesday's DTC	0	0	105	0
Closing Balance	100	25	205	100
(Overnight, all Wednesday checks become collected)		75 100		105 205
Thursday				
Opening Balance	100	100	205	205
Customer Deposits	100	25	0	0
Wednesday's DTC clears	(105)	(105)	0	0
Thursday's DTC	0	0	110	0
Closing Balance	95	20	315	205

The Hutton check deposited into the branch account was not actually drawn on the concentration account but rather on a separate account maintained for the sole purpose of issuing these "branch reimbursement checks." For simplicity, in order to show the net effect on Hutton, the concentration account and the branch reimbursement account are combined in this Table.

(2) Effects of "Float"

Deposits of immediately available funds are not the only way banks can enjoy excess collected balances. Such balances can also be created by the "float" that results from delays inherent in the check clearing system.

"Float" arises from the occasional differences between the time in which a check is scheduled to clear and the time in which the check actually clears. For more than 30 years the Federal Reserve System has been committed to clearing any check drawn on one member bank and deposited in another within two days, and many checks clear in one day. Many banks are also members of local clearing houses, at which they can clear checks drawn on one another within one day, and clearing can also occur through networks of correspondent banks. Banks make studies of how long it takes checks drawn on other specific banks to clear, and they will often treat a deposited item as "collected funds" when the item is scheduled to clear, rather than when it actually clears. Thus, each of the twelve Federal Reserve Banks can usually clear a check drawn on a member bank within its district in one day if the presenting bank[7] gets the check to the Fed by a certain deadline, and the

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[7] The "presenting bank" is the one seeking to collect the check; it may be the bank in which the item was originally deposited or a correspondent of that bank.

Fed will therefore give credit on such an item to the presenting bank in one day *even if the Fed is subsequently unable to present the item to the bank on which it is drawn within the scheduled time frame*. Such a clearing failure can result from many causes -- weather or other transportation delays, equipment breakdowns, checks that are smudged or wrinkled so the magnetic ink line at the bottom cannot be machine read, and so on. Regardless of the cause, however, the effect of a clearing delay is always the same: the funds represented by the check are treated as "collected" in two separate locations at once.

Suppose, for example, that a $100 Hutton branch DTC is deposited in a regional concentration account in the same Federal Reserve District as the bank on which it is drawn. The regional bank will get the DTC to the Fed that night and receive credit for it the next day, since the Fed knows it is scheduled to collect the check then. If the roads are icy, however, the check may be a day late getting to the branch's bank -- which means that the funds that were supposed to be pulled out of the local bank by the DTC will stay on deposit an extra day. This would *not* affect the regional bank; during the July 1980 - February 1982 time frame the Fed did not make adjustments when items failed to clear.[8] But the local bank

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[8] Under the impetus of the Monetary Control Act of 1980 the Fed began making such backcharges in 1983, in addition to vastly improving its check clearing system to substantially reduce this "float."

READEX FICHE

will have an extra day's use of the funds as a result of this "float," thereby obtaining an extra day's interest benefit.

It was (and is) Hutton's view that it is entitled to the benefit of any float on checks Hutton deposited. The Hutton drawdown system therefore had a mechanism to "recapture" float from the branch banks when Hutton DTCs failed to clear on time. This mechanism operated in much the same way as did the DTC adjustment for immediately available funds: when float (and thus an excess collected balance at the local bank) was detected, the size of a subsequent DTC was increased to make the local bank sufficiently uncollected so that the average collected balance would come close to the target compensating balance.

Mr. HUGHES. Thank you very much.

At this point, I am going to recognize the ranking Republican on the subcommittee, Mr. McCollum, and what we have agreed to do is to bring some order out of what is a very complicated situation, we have agreed that we are trying to pursue lines of questioning in particular areas.

First, with corporate structure. For that purpose, the Chair recognizes for 5 minutes the gentleman from Florida.

Mr. MCCOLLUM. I would like to inquire, first of all, as to the role that, in the corporation, each of the individuals here today play. I know we have the titles before us but, and you've introduced yourselves to us, but how do you each fit into the corporate structure of the holding companies represented? Could you explain that for us, Mr. Fomon, or would you like someone else at the table to do that? I would just appreciate it on the record.

Mr. FOMON. I will start, and any of them can butt in.

Mr. MCCOLLUM. Fair enough.

Mr. FOMON. During this period, Tom Lynch was chief financial officer of the company. Michael Castellano was comptroller of the company, and Tom Morley was in charge of money mobilization. As comptroller of the company, Mike Castellano was responsible for the accounts of the company, certain regulatory matters. As comptroller of the company, he was not charged with observing what went on in the money mobilization area.

Tom Lynch, as chief financial officer, again was not involved in the treasury functions, in the money, in the cash management areas. That was part of our operations department. As a matter of fact, it probably did not belong in the operations department, and since that time I have moved money mobilization and cash management out of the operations department into a different department under different management.

Mr. McCollum. Let me ask you, in terms of the way the corporation is structured, if you have a board of directors. Do you have a holding company? Is that correct? Can you give us some idea of the overall umbrella of E.F. Hutton for our understanding of that——

Mr. Fomon. We have a holding company that owns that broker-dealer where these activities took place. It was a broker-dealer that entered into the plea with the Justice Department.

Mr. McCollum. Now, Mr. Lynch, today you are the president of the holding company and you were the chief financial officer of the subsidiary before, or——

Mr. Fomon. Well, this is rather complicated.

Mr. Lynch. I am currently vice chairman of the board of the holding company, having assumed that title earlier this month. I was the president of the holding company from December 15, 1983 until earlier this month.

During the period under review, I was an executive vice president.

Mr. McCollum. Of the holding company?

Mr. Lynch. Of the holding company, and of the broker-dealer.

Mr. McCollum. And you were the chief financial officer in that capacity?

Mr. Lynch. Yes.

Mr. McCollum. At that time?

Mr. Lynch. At that time.

Mr. McCollum. I understand that.

Now, the brokerage company itself is a subsidiary of the holding company.

Mr. Lynch. Yes.

Mr. McCollum. What other subsidiaries of the holding company are there? Are they numerous, or are there——

Mr. Fomon. Well, we have an insurance company, which is a subsidiary of the holding company. We have a credit corporation, which is owned by the holding company. Those are the two principal other corporations held.

Mr. McCollum. Now, the brokerage subsidiary that you are here and we are here about today is the one the public most readily identifies as E.F. Hutton.

Mr. Fomon. Yes.

Mr. McCollum. And it is this company that all of the testimony today, this subsidiary, will be about in our exploration, is that correct?

Mr. Fomon. Yes.

Mr. McCollum. In terms of the two individuals in the mid-level of management we keep hearing about that were pinpointed as being primarily responsible and involved in all of this; where did they fit in to the subsidiary? What level of management are we talking about relative to the four of you gentlemen sitting here today?

Mr. Fomon. I am glad you asked me that because I don't know who they are.

Mr. McCollum. OK. So, if you don't know who they are, you don't know where they fit in.

Mr. **Fomon**. That is correct.

Mr. **McCollum**. But it is your understanding that they were somewhere down the road?

Mr. **Fomon**. I don't know who they are, I have no idea whom Justice is talking about when they talk about two middle-level individuals.

Mr. **McCollum**. When did the activities of this nature come to your attention at your level of management? When did all of this first get to your desk, Mr. Fomon?

Mr. **Fomon**. In February 1982.

Mr. **McCollum**. And how did it get to you? Who brought it to your attention?

Mr. **Fomon**. Our General counsel came to my office accompanied by outside counsel and told me that we had a problem in our banking activities, and I said do what is ever necessary to cure it.

It was about the time of the Genesee County bank problem in Batavia, NY.

Mr. **McCollum**. Did you have a board meeting to discuss this?

Mr. **Fomon**. No, I did not.

Mr. **McCollum**. Now, the board of directors of E.F. Hutton, while we're still talking about structure, and I think my 5 minutes is about up, but I want to see how this fit into the structure—is there a separate board of directors for the subsidiary?

Mr. **Fomon**. Yes.

Well, we have a board of directors for the subsidiary. A lot of the directors overlap on both——

Mr. **McCollum**. On both boards. But, at the beginning of this, when this was first brought to your attention, there wasn't a board meeting of any, of either level, is that correct?

Mr. **Fomon**. Correct.

Mr. **McCollum**. To discuss it.

Mr. **Fomon**. Right.

Mr. **McCollum**. My time has expired. I think we've got it started at least, Mr. Chairman.

Mr. **Hughes**. Thank you very much.

Gentleman from Ohio, recognized for 5 minutes.

Mr. **Feighan**. Thank you very much, Mr. Chairman.

Mr. Fomon, if I could I'd like to direct your attention to a particular problem that apparently was discussed with the prosecutor in this case and the banks involved in the case.

It is my understanding that, and I think you'll confirm this, that checks are——

Mr. **Hughes**. Would the gentleman yield to me?

[No response.]

Mr. **Hughes**. The consensus that we've arrived at is that we will endeavor to keep our line of questioning to corporate structure and then move on to other areas, and I would hope that the members would do that. We operate under a handicap to begin with, the 5-minute rule. You can't really develop a decent line of questioning, and I think we can best get over all the areas if we exhaust the various areas of questioning, and unless the gentleman feels that we haven't exhausted the structure, I'm not satisfied that we have all the answers relative to corporate structure.

Mr. Feighan. Mr. Chairman, I'd be happy to continue with that line of questioning——

Mr. Hughes. All right.

Mr. Feighan [continuing]. As long as I'm sure that we will have an opportunity to return to more specific——

Mr. Hughes. I can assure the gentleman that we will.

Mr. Feighan. Good.

Mr. Fomon, let me then continue with the relationship that your central offices had with your branch offices, and your office, through your corporate counsel, became aware of many of these problems, as you indicated, early in 1982.

Beginning in that point, what efforts were made to deal, rather than moving up with your board of directors, moving down in the corporate structure, to deal with your branches in order to advise them of the concern that upper management had with some of these practices?

Mr. Fomon. Well, as I recall, the first problem we identified was in the area of the multiple transfers, and it was only much later that we became aware of the excessive draw downs.

At the time we identified the first multiple transfer, that branch and that region were told to cease immediately. At that time we had no idea that this was a widespread practice within the firm, so we instructed the regional personnel and the branch personnel in that region to cease immediately.

Mr. Feighan. Could you let me back up just a bit then, and ask you if you could describe the relationship and the amount of exchange that takes place between corporate headquarters, regional offices, and the branches.

Mr. Fomon. Well, there's substantial exchange, both on the sales level, and on the operations level. It's not done out of my office. The head of the operations department communicates with the branch cashiers, the regional cashiers, the regional operations heads, the branch operations people, and the president of the company communicates at the sales level with all the branches. The president of the broker-dealer.

Mr. Feighan. To what extent are the—what is the chief operating officer of a regional office termed?

Mr. Fomon. He's called the regional vice president.

Mr. Feighan. And how many are those?

Mr. Fomon. Nine.

Mr. Feighan. And to what is there specific relationship with the corporate office? What is the level of exchange—could you describe generally for us the nature of their relationships to the corporate office?

Mr. Fomon. They report to the president of the company.

Mr. Feighan. On what frequency?

Mr. Fomon. Well, telephonically it is quite frequent. I would say its at least weekly.

Mr. Feighan. Can you indicate with more specificity—are there regular meetings with those vice presidents? I'm trying to determine what opportunity there may have been to discuss with those nine individuals the problems that we are going to be talking about more specifically later on.

Mr. Fomon. OK.

There are not regular meetings. There are—there is at least one national meeting with them a year, but I'm not sure to what extent the regional vice presidents understood cash concentration any more than I did 4 months, 3 or 4 months ago.

They have regional cashiers, and regional operations people, whom they would normally rely on in these matters.

Mr. **Feighan**. One of the problems that I think that we face in identifying how the problems developed at E.F. Hutton, and why they were not, at least in the judgment of some people, addressed on a more timely basis, is not having a full understanding of the organizational structure of your company, and as part of our subpoena we had asked for an organizational chart. It is my understanding that that was not submitted.

Am I to understand that one does not exist?

Mr. **Fomon**. I am sorry it was not submitted, because I gave several to Griffin Bell, and if I would give them to him there is certainly no reason why I wouldn't give them to you.

Mr. **Feighan**. So we can anticipate receiving——

Mr. **Fomon**. Absolutely.

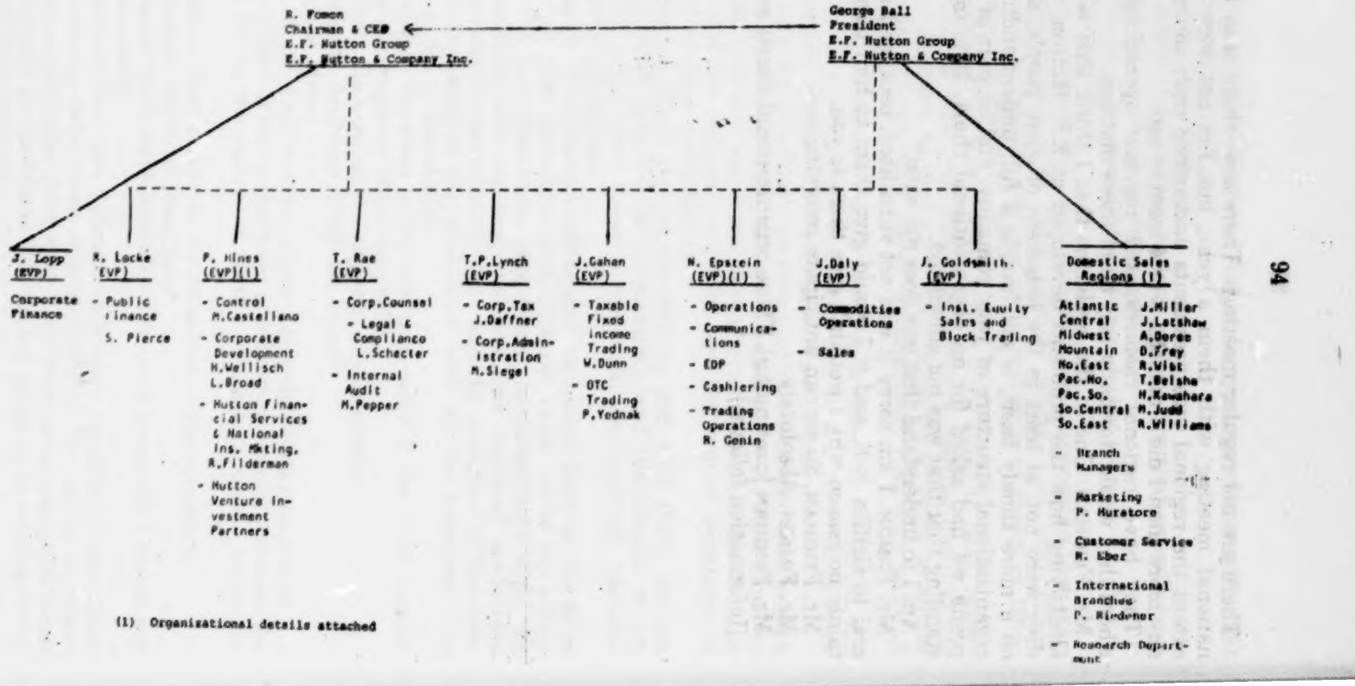
Mr. **Feighan** [continuing]. Those organizational charts soon.

[Information follows:]

SUBJECT TO REVISION

EXECUTIVE ORGANIZATION

Prepared on 6/21/85
as of
December 31, 1981


R. Fomon
Chairman & CEO
E.F. Hutton Group
E.F. Hutton & Company Inc.
George Ball
President
E.F. Hutton Group
E.F. Hutton & Company Inc.
J. Lopp (EVP)
Corporate Finance
R. Locke (EVP)
- Public Finance
S. Pierce
P. Hines (EVP)(1)
- Control M.Castellano
- Corporate Development H.Wellisch L.Broad
- Hutton Financial Services & National Ins. Mkting. R.Filderman
- Hutton Venture Investment Partners
T. Rae (EVP)
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- Legal & Compliance L.Schecter
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T.P.Lynch (EVP)
- Corp.Tax J.Daffner
- Corp.Administration M.Siegel
J.Gahan (EVP)
- Taxable Fixed income Trading W.Dunn
- OTC Trading P.Yednak
N. Epstein (EVP)(1)
- Operations
- Communications
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- Cashiering
- Trading Operations R. Genin
J.Daly (EVP)
- Commodities Operations
- Sales
J. Goldsmith. (EVP)
- Inst. Equity Sales and Block Trading
Domestic Sales Regions (1)
Atlantic J.Miller
Central J.Letshaw
Midwest A.Doren
Mountain D.Frey
No.East R.Wist
Pac.No. T.Belshe
Pac.So. H.Kawahara
So.Central M.Judd
So.East R.Williams
- Branch Managers
- Marketing P. Muratore
- Customer Service R. Eber
- International Branches P. Riedener
- Research Department

(1) Organizational details attached

Mr. FEIGHAN. Let me just ask, as my time is concluding, who are the individuals that you would identify in, first, in the corporate center offices having direct responsibility for cash management activities?

Mr. FOMON. Well, cash management activities is a very broad term, but Tom Morley is in charge of cash management.

Mr. FEIGHAN. Am I to assume that beyond Mr. Morley there is no one that you would identify in the corporate center offices who has direct responsibility for cash management?

Mr. FOMON. I think that's one of the problem—one of the things that caused all of our problems. We did not have anybody specifically accountable for the cash concentration system.

Tom Morley taught the approved cash concentration system. He taught it to regional officers, he taught it to branch officers. They violated those practices.

Now, if you would ask me why they violated them, there could be a number of reasons. These occurrences took place in a very high interest rate environment. Every corporation in America was looking for ways to increase interest profit, and reduce interest cost. Some of our personnel became too aggressive, and you are familiar with the results.

Mr. FEIGHAN. Thank you very much, Mr. Chairman.

Mr. HUGHES. OK.

I wonder if you could give us some idea of when you could make available to us your corporate structure?

Mr. FOMON. The chart?

Mr. HUGHES. Your organizational chart.

You know, it is unfortunate that we haven't had that——

Mr. FOMON. It is very——

Mr. HUGHES [continuing]. Available to us, because we're now forced to go through——

Mr. FOMON. I apologize.

Mr. HUGHES [continuing]. This time now, trying to reconstruct, you know, the organizational chart, which I'm sure is readily available.

Mr. FOMON. I assume you—I apologize for the fact you do not have it today. I assume what you want is the organizational chart as it existed during this period.

Mr. HUGHES. Can you have somebody make that available to us today? We still have some time yet today, and I can't believe that we don't have an organizational chart available that will enable members to understand the chain of command.

Mr. FOMON. I cannot get you a complete organizational chart today. I can get you an organizational chart that goes to the senior people in the firm.

Mr. HUGHES. Can you give me an explanation as to why this wasn't made available to us?

Mr. FOMON. No, I cannot.

Mr. HUGHES. I mean, of all the things that we requested, that's the one thing that should be very readily available for this committee.

I wonder if, before I recognize the Democrat from Florida, I wonder if the gentleman from Florida will continue to, at this point, try to reconstruct the organization, both the parent corporation as well as the subsidiary, line of command down to the regional and branch offices, so we can get some idea of areas of responsibility and command.

Gentleman from Florida.

Mr. **Shaw**. Thank you, Mr. Chairman. I will try to continue along those same lines, but I am somewhat fascinated——

Mr. Fomon, you mention that there was a system that was set up, and there was a breakdown in that system. How do you explain that that breakdown was pretty consistent through all your regions, and through all your offices? It almost appears that someone was giving instructions from the senior offices.

Mr. **Fomon**. Well, you would think so, but I have no reason to believe anybody in senior management devised that breakdown. I believe that it was mouth-to-mouth communication among regions and branches.

You have to keep in mind that in a firm that is managed, to a great extent, on a decentralized basis as E.F. Hutton is, that there is tremendous performance competition among branch offices. Each branch wants to show better operating figures than the next. And so they push to excesses in devising interest schemes.

Mr. **Shaw**. Let's talk about that for just a moment. Now, you mention in your testimony that in 1982 this was brought to your attention by your corporate counsel, and you told him to do what is ever necessary.

Mr. **Fomon**. Um-hum.

Mr. **Shaw**. Did you ask him at that time, in any specificity, as exactly what the problem was, and at what level of management it existed?

Mr. **Fomon**. Well, I don't know if I specifically asked him that, but that would obviously be part of their investigation.

Mr. **Shaw**. Did you at that time, then, talk to Mr. Morley about this?

Mr. **Fomon**. No, I did not.

Mr. **Shaw**. And when you say that corp—upper corporate management was involved, do you include Mr. Morley in that category?

Mr. **Fomon**. I do not consider Mr. Morley senior management of the firm, no.

Mr. **Shaw**. Mr. Morley, what is—who do you report to in the company?

Mr. **Morley**. In the timeframe——

Mr. **Shaw**. During the period of time that there was a Federal investigation.

Mr. **Morley**. 1982?

Mr. **Shaw**. Yes, sir.

Mr. **Morley**. I reported to Bob Ross.

Mr. **Shaw**. And who is that?

Mr. **Morley**. He is a senior vice president in charge of cashiering.

Mr. **Shaw**. Now, do the regional—what connection do you have to the regional vice presidents. I think you said there were some eight, or approximately nine——

Mr. **Morley**. Nine.

Mr. **Shaw**. Nine.

Mr. **Morley**. There were nine regions.

I had no reporting mechanisms to the regional vice presidents.

Mr. SHAW. Well then, how do you, as I think they call you, a money mover, or something——

Mr. MORLEY. Money mobilizer.

Mr. SHAW. Money mobilizer. Well, who reports to you so you can mobilize the money?

Mr. MORLEY. At that point I had one, two individuals.

Again, the money mobilizer function is—I think it would be helpful if I could explain exactly——

Mr. SHAW. I wonder if we can establish Mr. Morley's title at the time, because he has since received a promotion, and I understand he is now a senior vice president. That's Mr. Ross' position?

Mr. MORLEY. That's Mr. Ross'—that was Mr. Ross' position then.

Mr. SHAW. Back in the timeframe 1979–82.

Mr. HUGHES. I wonder if we can establish the title, areas of responsibility and the line of command up and down the chain. I'm not clear on that.

Mr. SHAW. Yes, well if you would respond to the chairman, and then I'd like for you to then go back and explain exactly what a money mobilizer is, and also tell the committee what oversight authority you have over the whole picture, because I assume that, being a money mobilizer, that you're very much on top of this whole situation, which is the subject of our hearing today.

Mr. MORLEY. Let me answer, try to answer the first question.

I reported to Bob Ross, who was a senior vice president, and Mr. Ross reported to Norm Epstein, who was an executive vice president, who reported, I believe, to Mr. Fomon.

Mr. HUGHES. I'm sorry, I didn't——

Mr. MORLEY. I believe Mr. Epstein reported to Mr. Fomon.

Mr. HUGHES. The chairman.

Mr. MORLEY. The CEO and chairman, correct.

Mr. HUGHES. Not to the president?

Mr. SHAW. Not to the president?

Mr. HUGHES. Excuse me.

Mr. MORLEY. I believe that is correct.

Mr. FOMON. That's correct.

Mr. SHAW. Now, if you would continue as to exactly what your job description is.

Mr. MORLEY. The money mobilizer or cash management department at E.F. Hutton, in the timeframe that we are referring to, consisted of one to two people.

The primary responsibility of the money mobilizer was to finance the firm's inventory, with the particular banks we had, and to set procedures for the cash management department, to execute letters of credit, to handle the commercial paper, and to do some of what we call cash management consulting.

Mr. SHAW. What relationship did you then have with the regional vice presidents in this regard? Who from various regions would talk to you?

Mr. MORLEY. The relationship—the regions did not report to me. The regional vice presidents I would have limited conversations with.

Mr. **Shaw**. Well, who would you have extensive conversations with? Because someone has to give you various information with regard to the inventory and the——

Mr. **Morley**. That would be done through—we had a cash forecasting, or we had a daily cash flow, where we would determine the corporate needs, and we had, basically we did it with the input from the trading areas and from the accounting areas as far as what our needs were.

Mr. **Shaw**. Who gave you these forecasts?

Mr. **Morley**. It would come from the—there was an area called the cash desk or the syndicate department——

Mr. **Shaw**. There was one in each region?

Mr. **Morley**. No, I'm talking from the corporate level. The regions would give me nothing relative to their financing. The system, as it existed, would be, as we explained, so balancing——

Mr. **Fomon**. Tom, I think the question related to whom you had contact with in the various regions——

Mr. **Morley**. Yes, it is.

Mr. **Fomon** [continuing]. And I guess the answer is the regional cashiers.

Mr. **Morley**. The regional operations manager and the regional cashier I would have contact with.

Mr. **Shaw**. Now, you mentioned a central desk on cash forecasting. I'd like to get into that a little bit.

Who was that, and where was that located? From your answer in your statement I assumed that there was one person that was giving you forecasts as to what cash balances would be anticipated, which you could write against in advance, is that—am I correct on that?

Mr. **Morley**. No, we didn't do that. We did not write against advance. What we would simply get would be the balances from the cash desk.

Mr. **Shaw**. OK, now you've talked about cash forecast. Now, where do they come from? What did you use that for?

Mr. **Morley**. If we have a particular need to finance an increase in our inventory, and we know we'll have it tomorrow or the next day, the syndicate department or the trading department would give something to us saying "I have a big settlement tomorrow" or whatever the case may be.

Mr. **Shaw**. Now, would those things be erratic in the amounts from a day to day, or are they pretty flattened out?

Mr. **Morley**. It would vary from day to day, depending upon our activity.

Mr. **Hughes**. The gentleman's time has expired.

The gentleman from Florida, recognized for 5 minutes.

Mr. **Smith**. Thank you, Mr. Chairman.

Mr. Morley, this scheme which Mr. Fomon has indicated broke down at some point, when was that first instituted inside the Corporation?

Mr. **Morley**. The scheme?

Mr. **Smith**. The plan, your cash management plan which called for depositing in local branches, having the regional banks or the concentration banks, having the major banks having the zero balance accounts: when was that kind of money moving, money management plan devised and put into implementation?

Mr. **Morley**. I would believe in 1979, but I'm not sure. I wasn't there when this plan was there.

Mr. **Smith**. Who devised it?

Mr. **Morley**. I believe there was an individual named Bill Sullivan.

Mr. **Hughes**. Where is Mr. Sullivan now?

Mr. **Morley**. He left the Company.

Mr. **Hughes**. Where is he now?

Mr. **Morley**. I do not know.

Mr. **Smith**. Mr. Chairman, I would like for the record to indicate that I think it would be very important at some point in time to have Mr. Sullivan available, since he was the man who Mr. Morley claims——

Mr. **Shaw** I quite agree.

Mr. **Hughes**. Can we establish his title, and also, I might say to the gentleman, and for the gentleman from West Virginia that just arrived, I'd like to continue to develop the corporate structure if we could, because we still have not developed that fully, but its our intent to, of course, bring in any other witnesses that might have some relevant testimony for future hearings.

Mr. **Smith**. Well, Mr. Chairman, I think that this is part of the corporate structure, frankly, this is what I'm going to determine——

Mr. **Hughes**. Yes.

Mr. **Smith** [continuing]. How this plan was devised, and how it was implemented, which is part of the corporate structure.

Mr. **Hughes**. What if you can establish his title.

Mr. **Smith**. What was Mr. Sullivan's title, if you know?

Mr. **Morley**. I believe he was a Vice President, sir.

Mr. **Smith**. Now, and anyone can answer this question since we're dealing with corporate structure which Mr. Morley may not be exactly familiar with, when Mr. Sullivan implemented or devised this plan, did it have to be approved by somebody, and who was that somebody or group of someones?

Mr. **Fomon**. Well, I assume it was approved by the head of the operations department, who was Mr. Epstein.

Mr. **Smith**. That would have been the man to whom Mr. Ross——

Mr. **Fomon**. Yes.

Mr. **Smith** [continuing]. Was reporting to, and he was an Executive Vice President.

Mr. **Fomon**. I don't know if he was an Executive Vice President at that time. He is now.

Mr. **Smith**. Was this something that would have taken an approval of the Board to approve and implement?

Mr. **Fomon**. No.

Mr. **Smith**. He had the authority to do it on his own?

Mr. **Fomon**. Yes.

Mr. **Smith**. Now, as far as implementation, would that have required then a meeting between Mr. Epstein and the regional Vice Presidents?

Mr. **Fomon**. No.

Mr. **Smith**. Would it have required a meeting between Mr. Epstein and the regional cashiers and money managers?

Mr. **Fomon**. Well, to implement the system, yes, it would have required meetings with regional people. I don't know if Mr. Epstein was personally involved in those meetings.

Mr. **Smith**. Would that have required as company policy a memorandum or directive?

Mr. **Fomon**. It probably would have required a memorandum from Mr. Epstein or Mr. Ross.

Mr. **Smith**. Was, in fact, a memorandum written?

Mr. **Fomon**. I don't know.

Cash concentration procedures, as I understand it, are actually things that the banks are out selling as a service to teach corporations how to concentrate cash, is that not true, Tom?

Mr. **Morley**. The banks do sell some of the cash concentration services as part of their overall package.

Mr. **Smith**. Yes, well, except to the extent that we know in this case this was a consistent policy nationwide. You had a chain in each area——

Mr. **Fomon**. No, wrong. This was a perfectly legal, acceptable practice. The Justice Department never charged that there was anything wrong with a company's basic approved cash concentration system, they never even inferred it.

Mr. **Smith**. I haven't inferred it yet either.

Mr. **Fomon**. OK.

Mr. **Smith**. All I've said is——

Mr. **Fomon**. I'm sorry.

Mr. **Smith** [continuing]. That this was consistent nationwide throughout your company, therefore it would have required, if what Mr. Morley says and what you say is correct, that banks go around selling concentration plans, it would have required all these various banks in all these various places in the country to be selling the same program, and I doubt very seriously whether that would have happened.

I'm curious as to whether or not somebody seized upon one particular plan, and then implemented it through the company on a nationwide basis inside the company?

Mr. **Fomon**. That is what they were supposed to be doing.

Mr. **Smith**. Now, that would have required, you say, possibly, but not surely, a memo or some other written instructions to begin, if in fact it was implemented in 1979, to begin this practice nationwide, throughout the company's branches——

Mr. **Fomon**. I would assume so, sure.

Mr. **Smith**. All right.

I don't know whether or not we've requested that kind of memorandum——

Mr. **Hughes**. Yes, yes, we have.

Mr. **Smith**. Did we receive such memoranda?

Mr. **Hughes**. No, we have not.

Mr. **Smith**. We have not.

Mr. **Fomon**. I will do my best to see that you have that——

Mr. **Smith**. Thank you.

[Information follows:]

E. F. HUTTON
REVISED BANKING WORKSHEET
STEP I

INE #		COLUMN A BOOKS	COLUMN B
1.	Call Bank for Opening Available Balance (If Available Balance is not obtainable use bank's Ledger Balance)		+______
2.	EFH Opening Ledger Balance (Yesterday's Line 18)	______	______
3.	Yesterday's Drawdown (Yesterday's Line 15)		-______
4.	Yesterday's Late Deposits (Yesterday's Line 17)		+______
5.	Immediately Available Deposits (Wire in, cash, checks drawn on your bank deposited to the same bank)	+______	+______
6.	All Other Deposits	+______	
7.	Local Checks Issued & Funds Wired Out	-______	-______
8.	Normal Service Requirement		-______
9.	Special Service Requirement		-______
10.	Sub Total		....
11.	Friday Adjustment (Other days 0)*		+______
12.	Sub Total	....	....
13.	On Friday, if Line 12 Col. B is positive and greater than $25,000 wire out 80% of total and subtract amount here. If Line 12 Col. B is negative or less than $25,000 enter 0.	-______	-______
14.	Sub Total	....	______
15.	Drawdown**	-.......	
16.	Branch Reimbursement Check**	+.......	
17.	Late Deposits	+______	
18.	Closing G/L Balance	══════	

* On Friday:

If Line 10 Col. B was plus on Thursday
enter 0 here.
If Line 10 Col. B was minus on Thursday, take
2/3 of that number and add here.

** Look at Line 14:

If Col. A and B are both plus, drawdown the total
and enter on Line 15.
If Col. A and B are minus, issue BRC for the total
and enter on Line 16.
If Col. A is plus and B is minus, then net the two.
If the total is plus, drawdown and enter on Line 15.
If the total is minus, issue a BRC and enter on Line 16.
If Col. A. is minus and B is plus, issue a BRC for A and enter
on Line 16, and drawdown B and enter on Line 15.

Inter-Office Memorandum

EF Hutto

TO Regional Operations Managers

FROM Thomas P. Morley

SUBJECT Draw Down Procedure

DATE July 9, 1982

Attached is our revised draw down procedure. Please review with your regional cashier and/or interest specialist. There will be a conference call on 7/16/82, at which time the draw down procedure will be discussed and an implementatio date will be decided upon.

It is important that you review the worksheet prior to the call so we all will have a working knowledge of the procedure. Participation in the conference call is mandatory.

Thanks for your cooperation in this matter.

cc: Norman Epstein
Richard Genin
Robert Ross

FC 14A (Rev. 11/69)

BANKING

Line #	Column A Books	Column B Good Funds
1. Call Bank for Opening Ledger Balance	[redacted]	+.............
2. EFH Opening Ledger Balance (Yesterday's line 19)	+..............	-.............
3. Yesterday's Draw down (Yesterday's line 16)	[redacted]	-.............
4. Yesterday's Late Deposits (Yesterday's line 18)	[redacted]	+.............
5. Immediately available deposits (wires in, cash, checks drawn on your bank deposited to the same bank)	>..	+.............
6. All Other Deposits	+.............	[redacted]
7. Local Checks Issued & Funds Wired Out	-..............	- .. ..
8. Normal Service Requirement	[redacted]	-.............
9. Special Service Requirement	[redacted]	-__________
10. Sub Total	[redacted]	....
11. Thursday Adjustment (Other days 0) *	[redacted]	+.............
12. Friday Adjustment (Other days 0) **	[redacted]	-__________
13. Sub Total	....	....
14. On Friday, if line 13 Col B is minus, contact your regional cashier, (who will wire in Fed Funds) and enter amount here	+__________	+__________
15. Sub Total	....	__________
16. Draw down ***	-..............	[redacted]
17. Branch Reimbursement Check ***	+..............	[redacted]
18. Late Deposits	+__________	[redacted]
19. Closing +/- Balance	__________	

* On Thursday, if line 10 column B is minus, enter 2/3 of that number.
If line 10 column B is plus, enter 0.

** On Friday, if line 10 column B was plus on Thursday, enter 2/3 of that number. If Thursday's line 10 column B was minus, enter 0.

*** Look at line 15:
If Col A and B are both plus, draw down the total and enter on line 16.
If Col A and B are both minus, issue BRC for the total and enter on line 1
If Col A is plus and B is minus, then net the two.
If the total is plus, draw down and enter on line 16;
If the total is minus, issue a BRC and enter on line 17.
If Col A is minus and B is plus, issue a BRC for A and enter on line 17, and draw down B and enter on line 16.

Mr. FOMON [continuing]. But I do not know if we have records going back to 1979. We certainly would have some more recent records on how the cash concentration works.

Mr. SMITH. Now, at some point you indicated that this plan was perfectly legal and legitimate, and ran for a period of time, and then there began to become excesses——

Mr. FOMON. Right.

Mr. SMITH [continuing]. And people who, by virtue of the competitive nature of your business, even internally, began to develop what you consider to be schemes of their own, unauthorized.

Mr. FOMON. Correct.

Mr. SMITH. Mr. Shaw from Florida I think made an excellent point in that it seemed to be fairly consistent throughout the system, and on the same basis throughout the system. Would that have required the various people competing with each other to meet, and to discuss these items? Or do you think——

Mr. FOMON. Certainly they would have to be speaking to each other.

Mr. SMITH. If they were in competition with one another, would it be rational for them to give away this competitive edge that they might have had, to generate additional money to their competitors?

Mr. FOMON. Yes, it would have been.

Mr. SMITH. Do you have any records of the regional vice presidents or the regional money managers meeting together at any given time on this particular issue?

Mr. FOMON. Well, no, I have no records of that, but regional cashiers get together, branch managers get together at meetings as well as the regional vice presidents.

Mr. SMITH. Are there regional money mobilizers such as Mr. Morley is in the corporate headquarters?

Mr. FOMON. Well, any duty would be in that area on a regional basis would be assumed by the regional cashier, or regional branch, regional operations manager.

Mr. SMITH. Let me ask you, in the corporate structure, is it common for you to have problems that are of this nature, which ultimately wind their way down to be criminal problems——

Mr. FOMON. No.

Mr. SMITH [continuing]. Reported to you by the general counsel?

Mr. FOMON. I've never, to my recollection, I've never had a problem like this is my history.

Mr. SMITH. Can you tell me how it was the general counsel got knowledge of this before your corporate officers?

Mr. FOMON. Well, I don't believe he got knowledge of it until the Genesee County Bank episode, at which time we were called by the New York State Banking Department.

Mr. SMITH. And he was the one that ultimately received the information?

Mr. FOMON. Yes.

Mr. SMITH. The general counsel.

Mr. HUGHES. The gentleman's time has expired.

Mr. SMITH. Thank you, Mr. Chairman. The gentleman from West Virginia.

Mr. STAGGERS. Mr. Chairman, I have no questions at this time, I apologize.

Mr. **Hughes**. The gentleman from Connecticut.

Mr. **Morrison**. I'll pass if I might.

Mr. **Hughes**. Let me just, if I might, followup on the line of command.

As I understand it, Mr. Ross was then senior vice president. He reported—this is on the operations side, as I understand it——

Mr. **Fomon**. Yes.

Mr. **Hughes** [continuing]. To Norman Epstein, who was the executive vice president.

Mr. **Fomon**. Yes.

Mr. **Hughes**. He reported directly to you.

Mr. **Fomon**. Correct.

Mr. **Hughes**. Who was the president of the operating company during the period 1979-82?

Mr. **Fomon**. George Ball.

Mr. **Hughes**. Was there any communication between the money mobilizer and Mr. Ball, Mr. Morley?

Mr. **Morley**. Yes, there was some communication. I worked on a project—two projects—for Mr. Ball. One of them is what we call our asset management account when I first joined the company, and the second was establishing a commercial paper program for E.F. Hutton, and in working on those two projects, the asset management account was one that Mr. Ball had an acute interest in. I would issue him weekly, monthly reports as far as the progress of the implementation of this asset management.

Mr. **Hughes**. Aside from those two areas, was there any direct accountability to Mr. Ball——

Mr. **Morley**. Not that I——

Mr. **Hughes** [continuing]. In your office?

Mr. **Morley**. Not that I can——

Mr. **Hughes**. Who formed a part of your office, besides yourself, and you were a vice president at that time, as I understand it?

Mr. **Morley**. That is correct.

Mr. **Hughes**. What other officials or personnel did you have in your immediate office?

Mr. **Morley**. I had——

Mr. **Hughes**. Your money mobilizer office?

Mr. **Morley**. I had, in June 1980, I had a young man named Mark Willets, who was a loan clerk, and I had a young lady named Joan Restivo, who left in the middle of June——

Mr. **Hughes**. Of 1980?

Mr. **Morley** [continuing]. Of 1980. I didn't replace Joan until sometime in August 1980, with a gentleman named Kevin Mahoney. Kevin Mahoney worked for me for 1981 and the end of 1982, when he passed away.

Mr. **Hughes**. When were you promoted from vice president to a senior vice president?

Mr. **Morley**. I was—there was a—at the end of 1982 I was made first vice president, and in 1984 senior vice president.

Mr. **Hughes**. So you report now directly to Norm Epstein?

Mr. **Morley**. No; now I report to Paul Hines.

Mr. **Hughes**. Well, so, it is your testimony that there was no reason for your office to be communicating with the president, dealing with aggressive or excessive drawdowns?

Mr. **Morley**. No; my office was responsible for the procedures of the approved drawdown worksheet, as it pertained to the branches.

Mr. **Hughes**. You indicated that Mr. Phil Sullivan was the one that apparently devised the scheme as a vice president.

Mr. **Morley**. That is my belief, yes.

Mr. **Hughes**. All right. And am I to assume that, when you took over in your capacity as a vice president as money mobilizer, that you perpetuated the scheme?

Mr. **Morley**. I followed it, yes.

Mr. **Hughes**. Pardon me?

Mr. **Morley**. I followed it—I think it's clear—I didn't join the company until June 1980.

Mr. **Hughes**. Was there any time when you talked with any of your chain of command about this particular scheme?

Mr. **Fomon**. Mr. Chairman, would you please——

Mr. **Morley**. The scheme?

Mr. **Fomon** [continuing]. Would you please use the word "practice" or "procedure" or something? "Scheme" has an extremely bad connotation to it.

Mr. **Hughes**. Well, I hate to tell you, Mr. Fomon, but, you know, part of the scheme was major overdrafts which led to a wire and fraud conviction, and——

Mr. **Fomon**. Not at that time. I mean, we're talking about 1979——

Mr. **Hughes**. Well, from the records I've seen, Mr. Fomon, it would appear as if the practices had been in place since 1979. Now Mr. Morley——

Mr. **Fomon**. Just, just——

Mr. **Hughes** [continuing]. Mr. Morley happens to be the money mobilizer—I'm just trying to find out who is involved, you know, in the decisionmaking relative to these "practices," if you would prefer.

Mr. **Fomon**. Well, I think we should use the word "scheme" when we're talking about the deviations from the approved practice and policy.

Mr. **Hughes**. Well.

Mr. Morley, I wonder if you can share with us whether you had any discussions relative to these practices, the——

Mr. **Morley**. Yes, I——

Mr. **Hughes** [continuing]. The money mobilizer practices, the drawdown, the use of the multiplier, the use of bogus funds which forms the basis for the wire and fraud conviction?

Mr. **Morley**. As far as the drawdown worksheet, the one that was in place, I did have conversations with my management about implementing an automated drawdown worksheet.

Mr. **Hughes**. So what you're saying is that you did not discuss, at any time, with your senior vice president, Mr. Ross, or the executive vice president, this practice of not just drawing down on the basis of deposits, and using the multiplier effect, but also drawing down excessive amounts, you did not discuss that?

Mr. **Morley**. I did not discuss the practice of drawing down excessive amounts, no.

Mr. **Hughes**. There were no memorandums from your office to any of the individuals involved that I've mentioned, Mr. Ross, Mr. Epstein, Mr. Ball, to your knowledge?

Mr. **Morley**. To my knowledge, there were no memos regarding this bogus, or what you refer to as bogus——

Mr. **Hughes**. Any discussions or any memorandum at any time that bore on the subject of the success in certain regions of the country, and the reasons for their success, and the reasons for other areas not being successful?

Mr. **Morley**. In my office, sir?

Mr. **Hughes**. From your office.

Mr. **Morley**. Not that I can remember.

Mr. **Hughes**. OK.

And it is your testimony that none of the regional vice presidents were in any way involved in any discussions with your office, either at regional training centers, or at any other time to talk about—in reference to the money management practices?

Mr. **Morley**. In reference to the worksheet?

Mr. **Hughes**. In reference to the excessive drawdowns.

Mr. **Morley**. No, sir, not to my knowledge. Not to my memory.

Mr. **Hughes**. Now, you were aware of the excessive drawdowns?

Mr. **Morley**. I was not, sir.

Mr. **Hughes**. You were not aware of the excessive drawdowns?

Mr. **Morley**. No, sir.

Mr. **Hughes**. You were not aware of the additional income that was being generated at the branch offices?

Mr. **Morley**. No, sir.

Well, when you say the "additional income," are you referring to the excessive drawdowns, or the credit balances that were on the ledger of balances of the books of the company?

Mr. **Hughes**. Well, at some point Hutton went from a practice of just drawing down what was being deposited, plus a multiplier effect, to doubling that at the regional level, to a practice of drawing down many, many, many times what was deposited. Depositing $75,000 and drawing down $10 million, for instance.

You were not aware that all of a sudden these branches were generating that kind of activity?

Mr. **Morley**. No, sir.

Mr. **Hughes**. Who else in the company would have access to that information, besides yourself?

Mr. **Morley**. Well, see, I, when you say—access to what information?

Mr. **Hughes**. The amount of money being moved to your concentrated banks.

Mr. **Morley**. See, I didn't have access to that information.

Mr. **Hughes**. Who had access to that information?

Mr. **Morley**. Um——

Mr. **Hughes**. Did anybody in the company?

Mr. **Morley**. It went through the books and records of the company, but I don't know if anybody had access to the balances, I mean, the way the——

Mr. **Hughes**. You would have me believe that, you know, all these amounts are being deposited, a $75,000 deposit, and then a draw down of $10 million, which at one point amounted to $400 million, and nobody knew anything about it.

Mr. **Morley**. I'm sorry, that was a very bad deficiency in our system. The system—I didn't have the wherewithal, because the branches would draw their moneys into the regions, and the regions then would be drawing down by New York.

The area in New York that drew down the regions, they didn't report to—I didn't see what the activity was happening every day.

Mr. **Hughes**. Mr. Fomon, at the regional level, did any of the cashiers on the operations side maintain any records of the practices in the various regional offices bearing on draw down.

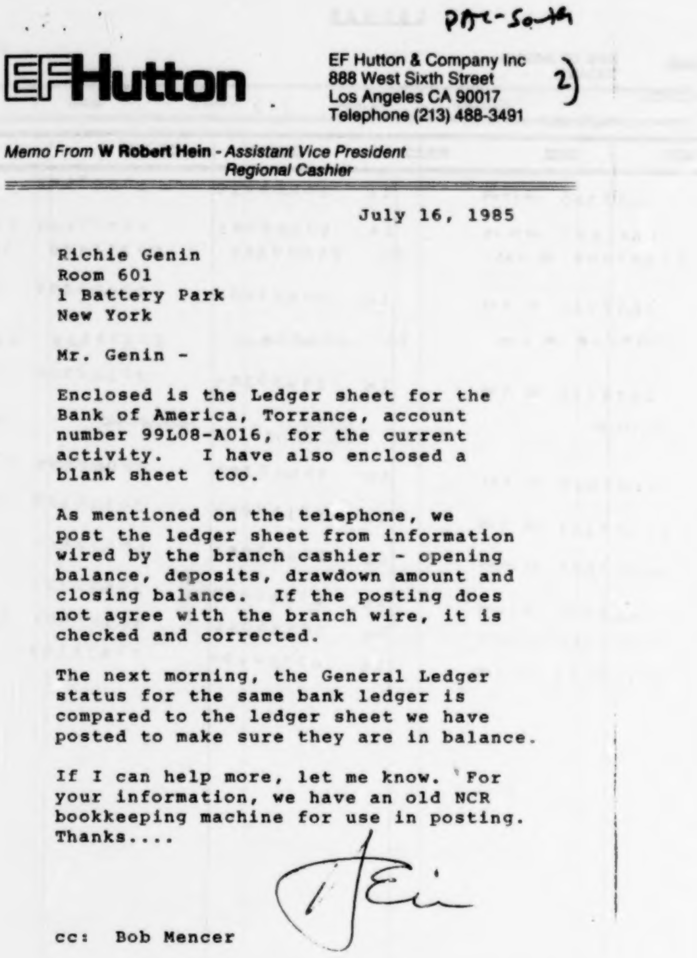
Mr. **Fomon**. I am sorry, I don't know.

Mr. **Hughes**. Is there any problem in getting that information, whether or not there is——

Mr. **Fomon**. No, there's no problem.

Mr. **Hughes**. All right.

[Information follows:]



PBC-South

2)

EFHutton

EF Hutton & Company Inc
888 West Sixth Street
Los Angeles CA 90017
Telephone (213) 488-3491

Memo From **W Robert Hein** *- Assistant Vice President*
Regional Cashier

July 16, 1985

Richie Genin
Room 601
1 Battery Park
New York

Mr. Genin -

Enclosed is the Ledger sheet for the Bank of America, Torrance, account number 99L08-A016, for the current activity. I have also enclosed a blank sheet too.

As mentioned on the telephone, we post the ledger sheet from information wired by the branch cashier - opening balance, deposits, drawdown amount and closing balance. If the posting does not agree with the branch wire, it is checked and corrected.

The next morning, the General Ledger status for the same bank ledger is compared to the ledger sheet we have posted to make sure they are in balance.

If I can help more, let me know. For your information, we have an old NCR bookkeeping machine for use in posting. Thanks....

cc: Bob Mencer

LEDGER

NAME BANK OF AMERICA
TORRANCE

ADDRESS

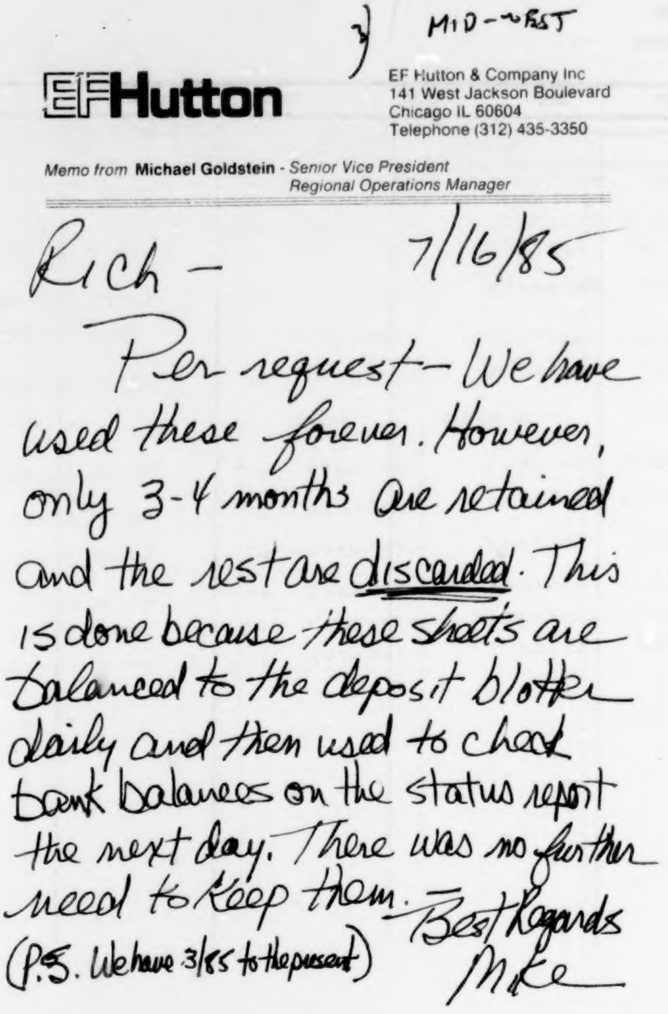
99L08-A016

ANCE	DATE	FOLIO	DEBITS	CREDITS	
16,333.65	JUN 27 85	16	162,664.12	106,079.00	72,918.77 ✓
72,918.77	JUN 28 85	16	473,227.03	432,259.00	113,886.80 ✓
113,886.80	JUL -1 85	16	215,003.86	292,111.00	36,779.66
36,779.66	JUL 2 85	16	948,294.94	934,030.00	51,044.60 ✓
51,044.60	JUL 3 85	16	~~220,508.16~~	202,785.00	68,767.76 ✓
68,767.76	JUL 5 85	16	244,331.64	221,325.00	91,774.40
91,774.40			220,538.16 Dep. of 7/3	~~220,508.16C~~	91,804.40 ✓
91,804.40	JUL 8 85	16	386,853.01	260,666.00	217,991.41 ✓
217,991.41	JUL 9 85	16	821,480.41	507,301.00	532,170.82 ✓
532,170.82	JUL 10 85	16	226,030.53	661,758.00	96,443.35 ✓
96,443.35	JUL 11 85	16	292,620.33	355,353.00	33,710.68
33,710.68	JUL 12 85	16	503,360.96	325,079.00	211,992.64 ✓
211,992.64	JUL 15 85	16	657,644.99	778,311.00	91,326.63

NAME

ADDRESS

BALANCE	DATE	FOLIO	DEBITS	CREDITS



MID-WEST

EFHutton

EF Hutton & Company Inc
141 West Jackson Boulevard
Chicago IL 60604
Telephone (312) 435-3350

Memo from **Michael Goldstein** - *Senior Vice President*
Regional Operations Manager

Rich - 7/16/85

Per request - We have used these forever. However, only 3-4 months are retained and the rest are discarded. This is done because these sheets are balanced to the deposit blotter daily and then used to check bank balances on the status report the next day. There was no further need to keep them. - Best Regards

(P.S. We have 3/85 to the present)

Mike

DRAW DOWN SHEET DATE______________

	DRAW DOWN	COMMODITY	CLOSING BAL
F01 A001 Natl Bk Ann Arbor			
F02 A002 Comerica Detroit			
F03 A000 Old Kent Gr Rap			
F04 A001 Amer Natl Kalam			
F05 A002 Pacesetter Lansing			
F06 A002 Comerca Southfield			
F07 A000 Empire Natl Trav Cty			
F08 A001 Liberty Bk Troy C87			
F21 A001 Citizens Flint			
F27 A000 Union Marquette			
F29 A000 City Bk Jackson			
F25 A000 Fidelity Carmel			
F26 A001 Valley Amer S.B			
TOTAL Pg 1			

DATE ____________

	DRAW DOWN	COMMODITY	CLOSING BAL
F31 A000 Franklin Greenwood			
F35 A000 Mich Natl Saginaw			
F36 A000 Old Natl Evansville			
F44 A000 Liberty Birmingham 6.19			
F50 A001 Amer Flet Inpls			
F51 A000 Brighton St Bk			
F72 A000 Manuf Rochester MI			
F77 A000 First Am Plymouth			
F79 A000 First Am Muskegon			
F81 A000 1st Natl Terre Haute			
TOTAL Pg 2			

DRAW DOWN SHEET DATE ____________

	DRAW DOWN	COMMODITY	CLOSING BAL
F11 A000 First Am Wausau			
F12 A001 United Bk Madison			
F12 A002 First Wi Madison			
F14 A001 Heritage Milw			
F14 A002 1st WI Milw			
F16 A001 First Rock Is			
F17 A000 F& M Marq Mpls			
F14 A003 1st Milw.			
F20 A000 First Natl Peoria			
F22 A000 Northern - 1st Sec Oakbrook			
F23 A000 Coulee St La Crosse			
F24 A001 First Natl St Paul			
F28 A000 Bank of Carbondale			
F30 A000 First Barrington			
TOTAL Pg 3			

DATE________________

	DRAW DOWN	COMMODITY	CLOSING BAL
F33 A000 Bank of Naperville			
F34 A00 2 Eagle Bank Decauter			
F37 A000 MN Norwest Bloomington			
F38 A00 1 Marquette Bk --			
F39 A000 Bk No Shore Northbrk			
F41 A001 Harris Bk			
F45 A001 Colonial Rockford			
F48 A001 Community Flossmoor			
F49 A000 Amer Bloomington IL			
F59 A00 2 Davenport Bk			
F73 A00 1 Marine Bk			
F80 A000 First WI Eau Claire			
F82 A000 Peoples Marine Bk			
F83 A001 First Natl.			
F84 A000 Bank of Illinois			
TOTAL Pg 4			

REGIONAL DRAW DOWNS **DATE**

F97 1102
First Natl

F97 1106
Harris Tr

F97 1107
Northern Tr

TOTAL Pg 5

****

SPECIAL "C" ACCT

	DRAW DOWN	COMMODITY
TOTAL PG 1		
2		
3		
4		
5		
TOTAL		

****

REPORT TO NY

CEA 98F97 A500

GENL FUNDS 99F97 A001

SPECIAL "C" 99F97 A000

Mr. Hughes. My time has expired. The gentleman from Florida.

Mr. McCollum. Thank you.

Mr. Morley, you said that the area in New York that drew down the regions didn't report to you. What area of New York drew down the regions?

Mr. Morley. The cash desk.

Mr. McCollum. The what?

Mr. Morley. The cash desk.

Mr. McCollum. Cash desk.

Mr. Morley. Yes, that was the name.

Mr. McCollum. What is the cash desk?

Mr. Morley. It is the area in New York that books the debits and credits for the corporate accounts in New York.

Mr. McCollum. Is it an accounting office, or a bunch of computers, or what?

Mr. Morley. They input the activity into the computer, which then updates our records, the daily——

Mr. McCollum. Who at that time was running the cash desk?

Mr. Morley. Um, a gentleman named Mike Vacca.

Mr. McCollum. How do you spell his last name?

Mr. Morley. I believe its V-a-c-c-a.

Mr. McCollum. Was he a vice president of some sort?

Mr. Morley. I believe he was a vice president.

Mr. McCollum. Did you know him personally?

Mr. Morley. Did I know—yes, I did know him personally.

Mr. McCollum. Is he still with the company?

Mr. Morley. Yes, he is.

Mr. McCollum. What office does he hold today?

Mr. Morley. He is—I don't know what his title is—vice president, I believe.

Mr. McCollum. Mr. Fomon, could you tell us, do you know——

Mr. Fomon. I think Mr. Lynch would probably know.

Mr. McCollum. Mr. Lynch?

Mr. Lynch. I think Mike Vacca is either a vice president or a first vice president in the asset management division.

Mr. McCollum. Mr. Lynch, to whom did Mike Vacca report at that time? You were the chief financial officer.

Mr. Lynch. I think both Mr. Morley and Mr. Vacca reported to Bob Ross at that time.

Mr. Morley. I believe that is correct, yes.

Mr. McCollum. Now, in terms of the cash that was drawn down to Mr. Vacca's desk up there, you said, Mr. Morley, you didn't have any dealings with that at all. That was a separate operation Mr. Vacca oversaw. Is that correct?

Mr. Morley. That is correct. He would give—he would draw down and close his books, the books of the banks, and give us the next day the ending balance.

Mr. McCollum. And that would be reported to you so you could see the ending balance.

Mr. Morley. But it would be just the ending balance in our main operating account in New York, Manufacturer's Hanover, or whatever bank it may have been.

Mr. McCollum. All right.

What about the regional cashiers? You said you talked to them. What did you talk to them about?

Mr. MORLEY. I would talk to them about the cash management procedure, either on the—I mentioned previously about implementing the asset management account. That would be one topic I would talk to them about.

I would talk to them also about the draw down worksheet.

Mr. McCOLLUM. Did they have as their line or chain of command or duty or whatever reporting to you, or this is something you would do in order to do your job, talk to them?

Mr. MORLEY. I would do as part of my job, or if they had a particular question to a problem that they felt would pertain to me they would call me. But they did not report to me.

Mr. McCOLLUM. Was there anybody in the region who had a duty to report to you?

Mr. MORLEY. No, sir.

Mr. McCOLLUM. Mr. Fomon, to whom would the regional—this may have been repeated before, but I just want to bring it to date—who did the regional vice presidents have the duty at that time to report to?

Mr. FOMON. They reported to the then President George Ball.

Mr. McCOLLUM. Did the regional—everybody else in the region report to the regional vice presidents? Was it a strict chain of command, or did some other people out in the regions have a separate, independent chain reporting duty to somebody up higher?

Mr. FOMON. I think, to a certain extent, the regional cashiers and regional operations people had a dual reporting relationship with both the regional vice president and the head of operations in New York.

Mr. McCOLLUM. And who was the regional vice president head of operations at that time? Was that Mr. Ross?

Mr. FOMON. Well, no, the head of operations in New York was Norman Epstein.

Mr. McCOLLUM. I realize again I may be plowing ground twice. It is part of the problem of not having the chart and having all the names and everything else.

I just want to get this straight in my mind. I hope I'm not wasting the chairman's time here, but I want to get it clear.

Mr. HUGHES. No, as a matter of fact I think that we all benefit from going through the organizational structure. It is just unfortunate we don't have the chart, because it is kind of confusing.

I'm concerned now to get Mr. Morley's—your—role in proper perspective. I'm getting the picture that you are kind of the guy who planned this system, or worked it out, or supposedly implemented the system, but that you didn't have much to do with the executive function of its being carried out. Is that kind of a conclusion that I should be drawing?

Mr. MORLEY. That's the—the role that I had was the—this was the procedure, the monitoring and control of that would be placed in the hands of the people executing it in the branches, and the operations of the regions, that's correct.

Mr. McCOLLUM. And you didn't really have any role in monitoring that, other than just an accounting kind of observation of pieces, bits and pieces. You never saw the full picture that went to the cash desk?

Mr. MORLEY. The only thing that I saw was the end result of the daily activity, which would be encompassed by all our daily transactions.

Mr. MCCOLLUM. All right.

I'm going to get into one other area, if I have time here, Mr. Chairman.

Mr. MORLEY. Yes.

Mr. MCCOLLUM. And its related to this.

Mr. HUGHES. The gentleman has 2 minutes.

Mr. MCCOLLUM. I am interested in knowing how, and this may be Mr. Fomon's answer, or someone else's, maybe Mr. Lynch's—when you talk about this cash concentration system in the regional level, you've got your regional vice presidents and cashiers and so on, as I see it this was sort of a competitive thing to, you've indicated that earlier to us, as I believe, to manage well, to keep the system working, though I understand that not everybody agreed that, in retrospect, on how that system should have been working in detail, but working to the maximum benefit of the company in terms of getting cash moved through the system, not to lose money at least for the company.

Was there any kind of a system of rewarding the individuals in the regions for accomplishing this expeditiously and efficiently? Promotions presumably result from that, but was there any additional reward built into the operation of this whole thing?

Mr. FOMON. There was no reward at the regional level. Branch managers, as it has been pointed out, participate in the total, in a percentage of the total profits of a branch. Branch managers in E.F. Hutton, and almost all securities firms, participate in an amount equal to 10 percent of that branch's profits.

Interest profit is—these are all profits, profits from the brokerage business, profits from the principal business——

Mr. MCCOLLUM. So the branch manager in increasing the interest profit would also increase his commission, his percentage, his personal pocket.

Mr. FOMON. That's true.

I would like to point out that, from the illegal practices with which we were charged, it would not be a major impact on his bonus, because the legitimate interest profits, which come from margin accounts and come from operating bank accounts properly, is so big in relation to what he could ever make through these illegal practices, I cannot believe that these illegal practices could have motivated him to do them, I——

Mr. MCCOLLUM. But there were no bonuses for the regional people.

Mr. FOMON. No.

Mr. MCCOLLUM. Bonuses strictly to the manager of the branch.

Mr. FOMON. Correct.

Mr. MCCOLLUM. The local branches.

Now those local branch managers reported presumably to the regional vice president.

Mr. FOMON. That's correct.

Mr. MCCOLLUM. And so on within the system.

I think my 2 minutes is up, Mr. Chairman. Thank you.

Mr. HUGHES. The gentleman from Connecticut.

Mr. MORRISON. Thank you, Mr. Chairman.

Let me just review for a moment. As I understand what was said earlier, Mr. Morley and Mr. Vacca both reported to Mr. Ross. Is that—do I understand that correctly? Is that the structure of things?

And, just following up on the question from the gentleman from Florida, your job was to conceptualize this cash management system, and Mr. Vacca was really the one who implemented that process, is that right? He's the one who would see the fruits of this process going on?

Mr. MORLEY. He would see the results of the daily activity of the branches going to the regions, and then the regions into New York. He would be the—in that department they were drawing down the regions.

Mr. MORRISON. So he was the person that was making the ultimate drawdown in New York of all the results of this process.

Mr. MORLEY. From the regions, that is correct.

Mr. MORRISON. The regions were drawing down within the regions, but he was making the ultimate New York drawdown.

Mr. MORLEY. That is correct.

Mr. HUGHES. Can we identify his full name and title?

Mr. MORLEY. I believe it is Michael Vacca.

Mr. HUGHES. How do you spell that last name?

Mr. MORLEY. I believe it is V-a-c-c-a.

Mr. HUGHES. Title?

Mr. MORLEY. Vice president.

Mr. HUGHES. Thank you.

Mr. MORRISON. Now, when he drew down these funds, where was he drawing—in other words, where was the deposit going that he was drawing down to? Where was the money going?

Mr. MORLEY. The money would be deposited either into one of our west coast concentration banks or into our New York concentration bank.

Mr. MORRISON. And who determined what the standard was as to whether it went to the west coast bank or the east coast? Was there a standard for that?

Mr. MORLEY. Well, there was a standard to the west coast. We would deposit a certain amount of money in the west coast bank to cover our zero balance checks. So there was a level given to Mr. Vacca every day.

Mr. MORRISON. And this was going into the zero balance account to cover what had already been drawn out of it?

Mr. MORLEY. To cover the daily checks there, that is correct.

Mr. MORRISON. And was that—was all the money going into zero balance accounts? Was Mr. Vacca basically drawing down all the money going to zero balance, or was there an excess that's going somewhere else?

Mr. MORLEY. Well, the amount of money he was depositing into Bank of America would be used to cover our check clearing from Bank of America.

Mr. MORRISON. So that was the zeroing out function?

Mr. MORLEY. Basically, yes.

Mr. **Morrison**. And he was just watching that balance and that's what he would deposit.

Mr. **Morley**. That's correct. Anything left over would be deposited into our New York account. There was a balancing procedure between the two——

Mr. **Morrison**. But there was a zero balance account in New York as well, right?

Mr. **Morley**. That is correct, yes.

Mr. **Morrison**. And he had to meet that amount as well.

Mr. **Morley**. He had to meet that, that's right.

Mr. **Morrison**. And then there was money left over?

Mr. **Morley**. Well, if there was money left over, it would go into the main concentration account in New York that night.

Mr. **Morrison**. And whose—what's the document or the basis—or where are the rules that govern that set of decisions? What document should we be looking at to understand that?

Is that a document you created as the conceptualizer of the system?

Mr. **Morley**. No, the document that would be created there would be the—well, in the case of the check clearing in Bank of America, it would be the ledger balance——

Mr. **Morrison**. But I'm saying, how did he know this was what he was supposed to do?

Mr. **Morley**. He had his standing instructions.

Mr. **Morrison**. In writing?

Mr. **Morley**. Yeah. We would balance—we would use Bank of America—we would pay off our check clearing every day, and we would balance our account with Bank of America on a daily basis.

Mr. **Morrison**. I understand. I'm just trying to find out where we find these pieces of information.

You say that there was a statement about what it was he was supposed to do, and——

Mr. **Morley**. There probably was a——

Mr. **Morrison**. Was that a document you issued, or where did it come from?

Mr. **Morley**. If it probably came, there probably was a note that came from Mark Willits or Kevin Mahoney, I mentioned before who worked in my area, that would tell Mr. Vacca what the closing bank levels at Bank of America should be.

Mr. **Morrison**. Now, your job, as I understand it, was to maximize the return on this cash that you were handling. Is that—I mean, that was your goal.

Mr. **Morley**. My job was basically liability management, in other words, how and where do we borrow our money from, the rate we pay, letters of credit, if we needed a letter of credit my department was responsible for issuing and following up on all letters of credit, the commercial paper——

Mr. **Morrison**. You weren't measured—your performance wasn't measured at all on what you earned with respect to the cash that was in the system. That wasn't of concern?

Mr. **Morley**. I don't believe so.

Mr. **Morrison**. Whose job was that? Who was it that was—that performance was measured on what kind of return they were getting on the cash within the system?

Mr. **Morley**. I don't know, sir.

Mr. **Lynch**. I think that there was no investment program, because any excess funds they used to pay down bank loans.

Mr. **Morrison**. OK.

So its really reduction of liability. I'm just expressing it wrong.

Mr. **Morley**. Yes, the——

Mr. **Morrison**. OK, so then your performance was measured on the degree to which you limited the cost of the money that you had to use in the system. Is that a fair statement of it?

Mr. **Morley**. Well, the cost I had nothing to do with, basically, it was based on interest rates.

Mr. **Morrison**. OK. I'll get the right words at some point if you'll help me.

The point is, what I really want to know is did it matter in your performance how well this cash management system was working. Was that a matter of concern in the review of your performance?

Mr. **Morley**. It was a matter of concern from an overall corporate policy. It wasn't an individual rewarding for——

Mr. **Morrison**. I didn't ask that. I just wondered whether you were——

Mr. **Morley**. It would just be a matter of concern to maximize the interest profit, yes.

Mr. **Morrison**. Maximize, excuse me?

Mr. **Morley**. Interest profit. In other words, whenever we had——

Mr. **Morrison**. Yes; I thought that's what I asked first, but I guess I didn't use the right words.

Mr. **Morley**. Excuse me.

Mr. **Morrison**. OK.

So you would be looking—is it correct that you would be looking at the performance of the various regions with respect to the interest that they were earning?

Mr. **Morley**. No, sir; because I didn't have the wherewithal to know what their interest profit—there are a number of different components in interest profit, of which I had no control over.

Mr. **Fomon**. I might interject that the interest profit of the regions was looked at by the regional vice president and by the president of the company.

Mr. **Morrison**. Who is Linda Curtiss? Can somebody tell me, anybody?

Mr. **Fomon**. She's an analyst in the corporate development department.

Mr. **Morrison**. Now, we have a document from Linda Curtiss in November 1981 which is a document that was directed to George Ball, Bob Eber, Paul Hines, and Peter Muratore. This is a report on a midwest regional planning meeting, and includes statements about aggressive overdrafting as a source of disproportionately high interest on general ledger balances.

Now, first of all, beyond Mr. Ball, who are these three people? Who are the other three people that I named? Who were they in the company?

Mr. **Fomon**. Well, Paul Hines at that time was in charge of corporate development. What were the other names? Linda Curtiss worked for him.

I don't recall the other names.

Mr. **Hughes**. Peter Muratore.

Mr. **Fomon**. Peter Muratore was a man in the marketing department. He was head of marketing.

Mr. **Lynch**. Bob Eber.

Mr. **Fomon**. And Bob Eber—I don't know what Bob Eber did.

Mr. **Lynch**. Bob Eber was a staff assistant to George Ball.

Mr. **Morrison**. Now, how long after November 1981 were the practices changed with respect to this excessive rate of draw down?

Mr. **Fomon**. The first change took place in February 1982.

Mr. **Morrison**. And how was that initiated?

Mr. **Fomon**. That was a result of the general counsel calling on me, and telling me about the Genesee Country Bank in Batavia, and that immediately prompted an investigation of the New York region, and the New York region was told to stop any of those practices. Those practices—at that time, we had discovered only the multiple transfer deviations in the system.

Mr. **Morrison**. Let me just read this statement in this memo, and I guess what I want—I'm just going to read you a statement, and I just want to understand whether this statement is a statement of concern, or whether this is a statement of commendation of the situation, because it is not clear to me. The memo says—

> As previously noted, the Central Region engaged in aggressive overdrafting of the bank accounts in several offices. These offices received as much as four days' float on their receipts.
>
> This aggressive overdrafting resulted in two offices, Washington 2 and Alexandria, contributing nearly 51 percent of the Region's interest income earned in overdrafting. Moreover, when interest earned on overdrafting was examined relative to intra-sensitive revenues for these offices, results were astounding.

And they go on.

Is that a compliment to what's going on, or a concern? Was this in accordance with plan, or was this something that was disturbing?

Mr. **Fomon**. I don't know. I'm not familiar with that memo. I wonder if I could have a copy of it.

Mr. **Morrison**. Well, you're certainly—I'll make a copy—but I'd assume you would know whether or not this kind of performance was what you were aiming for, or whether this was a matter that would give rise to concern that maybe you were doing something that wasn't in accordance with the plan.

Mr. **Fomon**. It sounds, frankly, from the part you've read, it sounds like it's complimentary to someone, but when they—they use the expression "overdrafting"?

Mr. **Morrison**. Aggressive overdrafting.

Mr. **Fomon**. That could relate to overdrafting on our own books. That does not necessarily mean that's violative of procedures.

Mr. **Morrison**. Aggressive overdrafting of the bank accounts of several offices. That doesn't sound like your own books?

Mr. **Hughes**. The gentleman's time has expired.

The gentleman from Florida.

Why doesn't the gentleman, if the gentleman will, pursue the memorandum.

Mr. **Shaw**. Yes; I'm going to pursue the question from the gentleman from Connecticut for just one moment.

I'd like to focus my attention now on Mr. Castellano and let these other gentlemen rest. It's getting to be something like a wrestling tag team, and we'll try to take turns on you. I'm sure it's going to be a long afternoon.

Mr. **Fomon**. I didn't think you'd ever get to him.

Mr. **Shaw**. With regard to the overdraft: how is that shown on the financial statements, and what account is that from? Now I'm talking about the bank overdraft, I'm not talking about overdraft in your own company, I'm talking about the ones that were just referred to in the memorandum.

Mr. **Castellano**. I don't have a copy of the memorandum, but, from what I heard, the overdraft that, if referred to by Linda Curtiss is what we would normally call a credit balance on a company's books for overdrafting a bank account.

Mr. **Shaw**. That is posted to a separate account, right?

Mr. **Castellano**. At that time, in 1981, it was not. What we have is an internal accounting system, whereby each branch is treated as a separate entity.

We take all of their assets and liabilities, and at that time it was all netted into one account, called net debit or net credit. Included in there was the bank balance, OK.

What we would do then is take the net debit or credit, and there would be an automated calculation of the interest expense, or credit, at the end of the month, and that all would go in one line called internal general ledger interest.

Mr. **Shaw**. And that would come to you. That's your responsibility as comptroller?

Mr. **Castellano**. No; that would just be calculated automatically and put on the P&L, and my responsibility was to make sure the P&L's were closed and distributed to the branch managers on a timely basis.

Mr. **Shaw**. Were you aware of what was going on?

Mr. **Castellano**. No, I was not.

Mr. **Shaw**. Why not?

Mr. **Castellano**. As comptroller of the company, my responsibilities were in the general accounting, budgeting, and reporting for the firm. I had no responsibilities at all in the operations end.

Mr. **Shaw**. Do you have an internal auditor?

Mr. **Castellano**. Yes, we do.

Mr. **Shaw**. Who is that?

Mr. **Castellano**. At the time I am not sure who it was. Currently it is David Denmark.

Mr. **Shaw**. And how long has he been there?

Mr. **Castellano**. David's been there for 7 or 8 years. He may not have headed it then, but he was in the internal audit department at that time.

Mr. **Shaw**. And now is he the——

Mr. **Castellano**. He is the head of internal——

Mr. **Shaw**. Who does he report to? Does he report directly to the board of directors?

Mr. **Castellano**. No. He reports to Tom Ray, general counsel.

Mr. **Shaw**. Who reports to whom?

Mr. **Castellano**. To Mr. Fomon.

Mr. **Fomon**. We have an internal audit department which presently is 60 people in addition to our legal department, which consists of probably 70 people.

Both the legal department and the internal auditors report to the general counsel.

Mr. **Shaw**. They are independent from operations, or anyone else. They report——

Mr. **Fomon**. Absolutely.

Mr. **Shaw** [continuing]. Directly to you as the chairman.

Mr. **Fomon**. No; they report to Tom Ray, the general counsel.

Mr. **Shaw**. Who reports to you as chairman?

Mr. **Fomon**. Correct.

Mr. **Shaw**. Is this how your general counsel became aware of what was going on, or was he aware of it after the investigators——

Mr. **Fomon**. No, no. It was not discovered by internal auditors.

Mr. **Shaw**. Do your internal auditors do any field audits?

Mr. **Fomon**. Pardon?

Mr. **Shaw**. Do they do any field audits?

Mr. **Fomon**. Yes, they do field audits.

Basically, what they've been concerned with is protection of client funds and customer funds, and rules and regulations of all the regulatory bodies. No one——

Mr. **Shaw**. Well, whose money was put into these accounts?

Mr. **Fomon**. Pardon?

Mr. **Shaw**. Whose money was put into these accounts?

Mr. **Fomon**. I still don't——

Mr. **Shaw**. Whose money was put into the accounts that we are concerned about?

Mr. **Lynch**. The money——

Mr. **Shaw**. Was that the customers' money?

Mr. **Lynch**. The money that went into the accounts, in fact, was Hutton's money, because it was in payment of obligations of customers; so, at the time it was received by Hutton it belonged to Hutton.

Mr. **Shaw**. So you had no—as to the accounts we are talking about, you had no fiduciary relationship as to the particular customers?

Mr. **Lynch**. No; because that money was owed to the firm, was paid to the firm, was put into the firm bank accounts, and was eventually going to be used to pay off firm obligations. It did come from customers, but it wasn't customer funds, it was money that the customers owed to the firm.

Mr. **Shaw**. Well, then, what—the internal auditor didn't look at that?

You say there is some 60 of them in that department. They didn't look at that on their field audit?

Mr. **Fomon**. I don't think internal auditors were ever charged with that kind of financial auditing. I don't know.

Mr. **Shaw**. Well, let's talk for a minute about your CPA's then. Who was your CPA at that time?

Mr. **Lynch**. Arthur Andersen & Co.

Mr. **Shaw**. That's certainly a very good name, a very good accounting firm.

Did they go out and look at these accounts?

Mr. **Lynch**. Arthur Andersen did a limited amount of field work. They visited several branches to test systems. They relied heavily on the work of the internal auditors.

The internal auditors on a regular basis visited all of our branches.

Mr. **Shaw**. But they didn't look at these accounts and see what was going on?

Mr. **Lynch**. I'm not certain as to what their scope was as it related to the branch bank accounts.

Mr. **Shaw**. Did Arthur Andersen, in any of its opinions to the stockholders, make an exception that would in any way imply what was going on in these accounts?

Mr. **Lynch**. No, they did not.

Mr. **Shaw**. I find that—as a former CPA myself, I find that somewhat——

Mr. **Lynch**. Well, nothing——

Mr. **Shaw**. How about the bank's CPA's? Did they ever bring this up to the board of directors or the stockholders of the various banks that this was going on?

Mr. **Lynch**. Not to my knowledge.

Mr. **Shaw**. I want to go back to, and talk for one moment about, the zero balance accounts.

Did you all have an established line of credit with this bank, and was this a contractual line of credit?

Mr. **Fomon**. Tom, why don't you answer that.

Mr. **Morley**. There was no line of credit established at the bank, it was just when the checks would clear we would pay off the checks by wire——

Mr. **Shaw**. They would just notify you that if, that there was so much money due in the account, and you'd go put it in. Is that correct?

Mr. **Morley**. That is correct. They'd notify the cash desk that there was—Bank of America would notify the cash desk, and any other——

Mr. **Shaw**. Did they ever advance any funds?

Mr. **Morley**. I'm sorry, the question?

Mr. **Shaw**. Did they ever advance any funds before the money showed up at the bank?

Mr. **Morley**. They may have, on occasion.

Mr. **Shaw**. But there was no contractual line of credit between Hutton and Chemical Bank, or Hutton and any of the zero balance banks?

Mr. **Lynch**. I think those same banks did have lines of credit with Hutton.

Mr. **Morley**. We had lines of credit, but they were what we call "broker lines" of credit.

Mr. **Shaw**. You call what?

Mr. **Morley**. "Broker."

Mr. **Shaw**. "Broker lines of credit."

Mr. **Morley**. Yes.

Mr. **Shaw**. Was this in the form of a contract?

Mr. MORLEY. No, it's not a committed line, it's simply a line that the bank will lend to us, if the money's available. There is no commitment on their part.

Mr. SHAW. OK, I want to talk about the local bank accounts for a moment. That's where all of this starts.

I assume that the bank activity is put into computers. Am I correct on that?

Mr. LYNCH. Yes.

Mr. SHAW. Is that computer data, does that go to your central offices?

Mr. MORLEY. It goes to the region, and it goes into three—I believe there are three copies. One came into the—my area. We were responsible for verifying a particular region, and one would go out to the regions, to balance their accounts at the regions.

Mr. SHAW. And then what was done with them after you got them?

Mr. MORLEY. We would—we had a particular category of accounts that we would have to balance, namely the corporate accounts. We would verify that to the cash desk who would give it to general ledger.

Mr. SHAW. The corporate, what you call the corporate account, is this, now that's not your local bank——

Mr. MORLEY. No.

Mr. SHAW. What is done with the printouts as to the activity in the local bank account?

Mr. MORLEY. It's given to the region.

Mr. SHAW. And then what does the region do with it?

Mr. MORLEY. The region is responsible for verifying that the closing ledger balance on our books and records is the same as——

Mr. SHAW. OK, does that account activity ever go to the corporate offices, your main corporate offices outside of the region?

Mr. MORLEY. The individual activity?

Mr. SHAW. Yes.

Mr. MORLEY. It would go into our accounting department.

Mr. SHAW. OK, so the comptroller would have it.

Is that correct, sir?

Mr. CASTELLANO. We—our responsibility as the cash was coming in over the wires, in other words, our responsibility was to balance the debits and the credits. At the end of the day, there was a run produced out of the computer which listed all the balances in the bank accounts for our books, and that was, I think those were the three copies that Tom is referring to.

We would retain one, so——

Mr. SHAW. So you would get the activities of these accounts.

Mr. CASTELLANO. Not me personally, but one of the areas under my responsibility would receive a copy of it.

Mr. SHAW. I would assume then that the activity of that particular account would reflect what was going on, wouldn't it?

Mr. CASTELLANO. When you say "reflect what was going on," it reflected what the balance was for our books.

Mr. SHAW. And the balance, at sometimes, for your books sometimes would say overdrawn, wouldn't it?

Mr. CASTELLANO. Yes.

Mr. **Shaw**. And sometimes that would be a rather consistent event in some of these, some of the local offices. Is that not correct?

Mr. **Castellano**. That is correct.

Mr. **Shaw**. Now, who do you report to?

Mr. **Castellano**. I report to Paul Hines, who is in charge of corporate development and control.

Mr. **Shaw**. And is he upper management?

Mr. **Castellano**. Yes, he is.

Mr. **Shaw**. Are you upper management?

Mr. **Castellano**. Yes, I am.

Mr. **Shaw**. So, I guess it would be safe to say that you were aware of what went on. Is that not correct?

Mr. **Castellano**. That's not correct.

Mr. **Shaw**. Why not?

Mr. **Castellano**. I was not responsible for the operation of the drawdown system.

Mr. **Shaw**. But those statements would come to your office.

Mr. **Castellano**. Not the statements, just the cash balance in the bank account for our books.

Mr. **Shaw**. Which would, in many cases, read "overdrawn."

Mr. **Castellano**. But, based on the policy, the approved policy that we had in effect, most branches would have a credit balance.

Mr. **Hughes**. The gentleman's time has expired.

The gentleman from Ohio.

Mr. **Feighan**. Thank you, Mr. Chairman.

Mr. Morley, let me summarize, if I can, what I understand at least part of your testimony to be thus far.

During the period of 1980 when you joined E.F. Hutton to at least early 1983 you were vice president and reported to Mr. Ross. You inherited a cash management procedure from Mr. Sullivan, the general parameters of which you understood to be known, not in detail, but at least those general parameters, by the senior management of E.F. Hutton, but there was developing within that practice schemes that were subsequently found to be illegal and which you were aware of. But, those schemes which you were aware of that were subsequently found to be illegal were not portions of the aggressive cash management process that those members of the firm senior to you were aware of.

Is that a correct summation?

Mr. **Morley**. Well, when you say I was aware of those schemes?

Mr. **Feighan**. I use that language distinction——

Mr. **Morley**. Are you referring to the drawdown sheet?

Mr. **Feighan**. I am referring to what I understand to be several elements, I don't think we've defined them all yet this morning, one of them would include the drawdown activity, check misencoding may be another, there apparently were several elements.

Mr. **Morley**. I was aware of the implementation of the drawdown sheet as when I came here. I was not aware of the schemes, any other schemes that I know of.

Mr. **Feighan**. Well, with respect then, just to clarify that to the drawdown activity, that the portions of that activity that were subsequently found to be illegal were activities that you were aware of, but that those you reported were not. Is that correct?

Mr. **Morley**. I was not aware of any illegal activities.

Mr. FEIGHAN. Let me ask you this then.

At what point were you aware of the activities which were found to be illegal?

Mr. MORLEY. I first became aware of an activity that was later found to be illegal—no, just wait—it was a meeting in December of 1981, where the regional vice president came into Norm Epstein's office and he said that he had received a complaint from a bank, and that he had engaged in what we call "multiple transfers." He was at that point told to stop.

Mr. FEIGHAN. And that was the first point in time at which you were aware that some of the activities may be deemed illegal.

Mr. MORLEY. That was the first time I became aware of the activities that led to the meeting with the State examiners that led to the—our internal investigation.

Now, I had received complaints from banks, but I did not consider a bank complaint to be something of illegal nature.

Mr. FEIGHAN. Don't misunderstand my question. I am not saying at what point did you make a judgment that certain activities were illegal, I'm only concerned about what point you were aware of the activities that were subsequently determined to be illegal. I understand that in that intervening time you may have not determined, and others may not have made the judgment, that they were illegal activities.

Mr. MORLEY. The meeting I had in December——

Mr. FEIGHAN. December 1981.

Mr. MORLEY. 1981. There was another instance in the middle of 1981 where somebody in our accounting department referred or said to me that somebody had taken excess deposit out of our Houston office.

I called the regional vice president—I'm sorry, I didn't call—he said he had called the vice president. What had happened, he had taken a check and drawn down in something excess than his cash deposit to that particular day.

Mr. FEIGHAN. Now, the process that you had inherited from Mr. Sullivan that began sometime, you understood it to have begun sometime in 1979.

Mr. MORLEY. 1978 or 1979. I'm not sure.

Mr. FEIGHAN. 1978 or 1979, sometime in that time period, and that you were essentially responsible for, certainly through and including 1982, and you did your job obviously very aggressively, and I'm sure it was viewed as very well, resulting in what was the intended result, and that was the dramatic increase in interest profits.

I assume that you could document to your superiors in that period of time that, in fact, you were doing your job well, and that E.F. Hutton was experiencing, I won't say unusual, but I will say welcomed, increased interest profits. That is correct?

Mr. MORLEY. No, sir, I did not document the net interest profit. That is something that our accounting department would have done.

Mr. FEIGHAN. Would that have been Mr. Castellano's responsibility?

Mr. MORLEY. Well, they had, they would prepare a report detailing our interest profits.

Mr. **Feighan**. Would you not receive, as the individual who is responsible for the whole practice, would you not received reports as to what the net result of that practice was?

Mr. **Morley**. No, sir.

Mr. **Feighan**. So you did not know whether or not the procedures that your office was following and proceeding with in conjunction with the nine regional vice presidents—you did not know whether or not those procedures were resulting in increased interest profit?

Mr. **Morley**. No, sir, I would not know what the net interest, the components of the net interest profit were to the company.

Mr. **Feighan**. Let me restate the question, because I didn't ask about the components of the net increase.

Were you or were you not aware of whether or not the procedures that you were following, and doing, and procedures that you were pursuing with the nine regional vice presidents, resulted in increased interest profits?

Mr. **Morley**. I wasn't able to measure if it resulted in net interest profit.

I would see the net interest profit, but what the result of the following of procedures had to do, I was not able to qualify that.

Mr. **Hughes**. Would the gentleman yield to me?

Mr. **Morley**. I'd be happy to.

Mr. **Hughes**. That almost defies logic. Your major function as a money mobilizer was to maximize deposits, maximize the use of the money.

Are you suggesting that at no time were you given information as to the success of the techniques that you had put in place?

Mr. **Morley**. What I was given would be the results, the results of the drawdown worksheet.

Mr. **Hughes**. Yes, but the gentleman from Ohio is trying to find out from you whether or not you ever received from your superiors a pat on the back and a "well done." I mean, "your practices and procedures have made money for Hutton, and we're appreciative."

Mr. **Morley**. I don't recall getting a "pat on the back" saying that my——

Mr. **Hughes**. You didn't receive any information at all from your—from anyone insofar as the kind of interest profit that was being amassed by Hutton as a result of the practices that you were responsible for?

Mr. **Morley**. Well, the practices that I was responsible for was the liability management as well as some of the other——

Mr. **Hughes**. Well, liability management includes a pay on the loans, which adheres to the benefit of the company. It's still profit, interest profit, isn't it?

Mr. **Morley**. It is, sir.

Mr. **Mazzoli**. Would my friend from Ohio have any——

Mr. **Feighan**. I would be glad to yield.

Mr. **Mazzoli**. I think I heard the gentleman, Mr. Morley, say he went from vice president, to first vice president, to executive vice president.

Isn't that a "pat on the back" for a job well done?

I believe that's fairly concrete.

Mr. **Morley**. I believe so, sir——

Mr. Mazzoli. Right.

Mr. Morley [continuing]. But I think the responsibilities that I had, again——

Mr. Mazzoli. I mean, I doubt very much that E.F. Hutton—just to continue to borrow my friend's time, would be promoting someone who wasn't doing a good job. So, whether you saw it, could measure it, quantify it, give percentage factors to it, clearly what you were doing was fulfilling the mission of that office.

Mr. Morley. That is correct, and that included some of the things that I referred to as far as starting up the Commercial Paper Program, implementing an Asset Management Program that we didn't have, and doing cash management consulting.

Mr. Feighan. I don't think there is any question that you were fulfilling the mission of the office, and I think that was duly recognized in course by your superiors at E.F. Hutton.

That you would testify, however, that you were not made aware as to whether or not the practices that you were responsible for or aggressively pursuing, practices that were not apparently consistent throughout the industry, and that were resulting in dramatically increased interest profits for E.F. Hutton, and that you were unaware of whether or not those practices, in fact, were resulting in those increased profits, is astounding for me to hear.

So be it. Let me ask you this, then.

Who was then responsible for receiving and for centralizing information with respect to interest profits generally, net interest profits?

Mr. Morley. I believe the accounting department, sir.

Mr. Feighan. Was it your understanding that that was information that Mr. Castellano would have had available?

Mr. Morley. I believe so.

Mr. Feighan. And it was information that you will again testify to that you did not receive?

Mr. Morley. I did not receive the information on a monthly basis, I received the information on—when we got the annual report, or the quarterly report.

I would receive a monthly report of the components of the interest profit from our accounting department.

Mr. Feighan. I have no further questions at this time.

Mr. Hughes. The gentleman from Kentucky.

Recognized for 5 minutes.

Mr. Mazzoli. Thank you, Mr. Chairman.

And, gentlemen, I know this is a difficult situation for you all to be in, because you're proud of your company and its record in the industry, but these questions really have to be asked.

I am reminded, as I have sat here during the morning, of the famous expression that "success has a thousand fathers, but failure is an orphan." I would in all honesty say that if E.F. Hutton had struck a home run for the country or the globe or the industry, and had acquired the accolades of the President and of the Congress for a job well done, if you had reversed the course of poverty and ignorance in the world, I would be willing to bet that each one of you could sit here and clinically tell us, with every single detail filled in, every "i" dotted, every "t" crossed, exactly your contribution to that acknowledged success.

But as I've sat here—and I'm not as conversant with the detail as my colleagues in the committee are—I have heard all of you gentlemen, in various ways, in effect suggest that you had no idea what was really going on, had no concept of its profitability, had no way of discerning who was doing what to whom, and yet, using the chairman's not hypothetical example, in one case a $70,000 deposit was kited into something like $10 million. I don't know how it was done, and I'm not really too concerned about all the minutia here.

I think what I am concerned about is what appears to me a very well orchestrated effort to do what my 6 years of experience in the House Intelligence Committee taught me was the art of deniability. You have made this whole plot, exercise, practice, scheme, deniable, totally not attributable, because of the way you have crafted it.

Now, I guess the question I would ask, if I were here as I am representing a lot of people who don't know a check scheme from left field, I guess the question I would ask is, how can you people draw hundreds of thousands of dollars a year in salaries and bonuses and rewards from a company without knowing what the hell the company's doing?

Now, let me ask you, Mr. Morley, first off: How can you sit there drawing quite a few dollars for a job that entails talent and enthusiasm and energy and ability, and say to us, as you did to my friend from Ohio, that you really didn't know what was going on?

All you're doing is turning figures in like some minister, like some Bob Cratchett who is scratching out figures with a quill-tip pen in a green eyeshade. Now tell me, how wrong am I in my little analysis here?

Mr. **Morley**. In retrospect, I agree with you. Again, it's not easy to sit here and say that, I do pride myself on doing a good job. I didn't perceive that there was a problem—at what level should our interest profits be? It is a very difficult thing to say.

Mr. **Mazzoli**. Well, if they are 10 percent better one year than the next, and 20 percent better the year after that, when the industry as a whole is going up 2 percent, wouldn't that show something?

Did you ever make that kind of analyzed analysis?

Mr. **Morley**. I never did, sir, I never made——

Mr. **Mazzoli**. Mr. Lynch, can I ask you the question?

Mr. Lynch, if I might ask you the very same thing that I asked Mr. Morley. You sat there and you've been a good servant to E.F. Hutton, you feel like you've increased the retirement opportunities of a lot of Americans in the land. Can you sit there and be satisfied with this fact that nobody seems to know anything that's been going on?

Mr. **Lynch**. Well, let me deal with the question of measuring interest profit, because I think this can be helpful, and Mike Castellano referred to it briefly before.

The Hutton system in place at that time simply calculated an interest or an interest credit on the net general ledger balance for each branch office. That general ledger balance contained the bank accounts, other accounts, the fixed assets of the branch. So the branch saw one charge or credit coming through for general ledger, saw a second credit coming through for interest on customer balances. This netted down to the interest profit of each branch office.

Mr. Morley's contribution in improving the performance of the branch by reducing the amount of money they left in bank accounts was blended into this number, because the branch——

Mr. **Mazzoli**. You know, it's an interesting thing. Let me just take you back a second.

My late father was a tilesetter, marble worker, terrazzo worker. Daddy did not get out of grade school. He opened his little company out of our garage, and ran it for many years, sent us to school.

My Dad, with all of his unsophistication, lack of schooling, could tell you to the mill exactly how much it cost to put up a tile bathroom. He knew it—he knew exactly the blend.

You're talking about this money was blended—a bathroom is blended. It's blended of concrete, ceramic tile, metal lathe, and labor. My Dad could unblend it very, very quickly, down to the penny.

You tell me that you simply can't unblend money, you can't unscramble that plate of spaghetti?

Mr. **Lynch**. No; I didn't say that. I said that Mr. Morley's contribution——

Mr. **Mazzoli**. Well, I'm asking you. I asked Morley—he can defend himself.

I really was asking you, Mr. Lynch, how you felt personally, not about your colleague, but, I mean, do you feel that you should, first of all, that you should have known something was amiss, something was going on sideways here, instead of straightforward?

Mr. **Lynch**. I was not aware that there was anything.

Mr. **Mazzoli**. I didn't ask that question, but I can understand why you would want to answer it that way.

Mr. Fomon, let me ask you just more or less what I asked Mr. Morley, about this theory of deniability, which I have learned so well over on the Intelligence Committee over my years there, you know. Again, pardon me if I am amiss, and tell me if I am; this seems like a beautiful exercise in deniability, of making something nonattributable to the source, so that you can deep-six somebody, this middle-level guy whose name has never come up, some wandering poor person who gets the blame heaped on him. In the old gangster stories, he was the "fall guy" who went up to Sing Sing for years, then he came back home, and, you know, the big shot got away.

Tell me how wrong I am in this situation, that the middle guy, the one who might even have the least ability, the least brains and intelligence to set this scam up, is left to hold the bag.

Mr. **Fomon**. Well, I'd start by saying, at the time of the indictment I'd made up my mind that I was going to do an internal investigation to find out what really happened. I did not. I was, on the advice of counsel—while the grand jury was sitting I was told not to do any internal investigation because it would possibly jeopardize the company or jeopardize individuals.

Mr. **Mazzoli**. I wouldn't repeat that statement too very often. Just for what you said, it doesn't sound like it's a particularly worthy piece of counsel advice, but go ahead.

Mr. **Fomon**. I then realized that I did not have the staff to do an nternal investigation, and, if I did one, it wouldn't have any credi- ility, because maybe I was covering up for some people in senior nanagement. So that's why I hired Griffin Bell.

You've been furnished a copy of the mandate I gave Griffin Bell, ou can——

Mr. **Mazzoli**. Mr. Fomon, if you excuse me a second, I don't want o be abrupt, my time is about to expire, but my question to you is ıot based prospectively, but retrospectively. How come you didn't now? How come you weren't worried?

Mr. **Fomon**. We did not have sufficient controls. I have said that epeatedly. I guess the reason we did not have sufficient controls is ecause no one ever dreamed that employees would abuse a draw- lown system that was perfectly legal. It never entered anybody's ıead that that would lend itself to abuses.

Mr. **Mazzoli**. Well, I accept that.

Mr. Castellano.

Mr. **Castellano**. Well, I agree with Mr. Fomon in that the con- rols were not there, basically because the design of the system, vhich was Tom Morley's, the implementation of the system, which vas operations, and the controls to make sure the systems were eing implemented correctly, were all in one division, namely oper- tions.

Mr. **Mazzoli**. Well, you know, that's like I say, the whole tack of leniability is to do exactly that, you know, to make sure that it is ıot traceable, the money cannot be got back.

Let me just finally wrap up my time here by saying that—to ask ery, very quickly, if you could just answer this question:

Mr. Bell, who is an eminent and respected person, is still con- lucting his investigation. Are you all not doing certain things ending his investigation, or have you clamped down on these "bad guys" where they're buried down at the $20,000-a-year level, wher- ver the hell they are?

Mr. **Hughes**. Wherever they are.

Mr. **Mazzoli**. Wherever the hell they are, right.

Mr. **Castellano**. Do you mean what have we done from a control tandpoint?

Mr. **Mazzoli**. I'm asking you from your standpoint and what ou're responsible for—can't you clamp down, regardless of when Mr. Bell gets to his final, because—his final appraisal of what went n——

Mr. **Castellano**. Yes, we have.

We have developed in the last 2 months an interest report that reaks out the bank interest, and not the total interests, as Mr. ynch referred to, but the bank interest by branch, by month, in a ime series that shows 6 months, so on one sheet of paper for every ranch we can tell whether they had interest credit or interest lebit.

In addition, we have made the organization change, which was ust announced very recently, splitting the responsibility into oper- tions, treasury, and control, so it's three different areas.

In addition we are working with the internal and external audi- ors to develop the audit procedures to make sure——

Mr. **Mazzoli**. Let me ask you this question. Are you satisfied enough with what you have done that if there was a check-kiting operation, or whatever you want to call this thing, procedure, process, that you'd know about it, and if you'd know about it, you should go to jail if somebody is performing some little dance down at the end of the string.

Mr. **Castellano**. We have developed——

Mr. **Mazzoli**. You would be prepared to say that the things are right enough that you'd go to jail if they weren't, right now——

Mr. **Castellano**. Well——

Mr. **Mazzoli** [continuing]. In 1985, June the——

Mr. **Castellano**. I don't like the term jail, but I would say that we have the——

Mr. **Mazzoli**. Would you take responsibility for whatever would be civil or criminal, for what is going on right now in E.F. Hutton, this very moment?

Mr. **Castellano**. I would take responsibility for the controls that are implemented to show us if this thing could ever happen again.

Mr. **Mazzoli**. Mr. Fomon, let me ask you that direct question. Are you satisfied enough with what you've done now, on your own, pending what Mr. Bell does, and what any of the other action, that you would not take full personal, even criminal, responsibility for anything which is going on down the line? Are you satisfied enough with what you have done?

Mr. **Fomon**. Well, I'm not satisfied in relation to what we will do in the future.

For example, we were wrong in leaving the bank relationships to each individual region. In the future, we will control——

Mr. **Mazzoli**. In the future? I thought the future was now. It is now, according to Mr. Castellano.

Mr. **Fomon**. All right. The future is now.

We will—we are setting up a system to control all of these——

Mr. **Mazzoli**. I thought it was setup. Excuse me—"are setting" or "is set" up?

Mr. **Fomon**. It is not set up.

Mr. **Mazzoli**. It is not set up?

Mr. **Fomon**. It is set up from Mr. Castellano's standpoint.

Mr. **Mazzoli**. I get the impression that there may not be complete accord at the table as to what has been done and what hasn't been done. I won't press the point, because you all may not have consulted, but you should have before today.

Mr. Lynch, are you satisfied, would you put your neck on the line for what E.F. Hutton has done?

Mr. **Lynch**. Well, the changes in the reporting relationships, the new controls and procedures are not under my jurisdiction, either under Mr. Castellano's, or——

Mr. **Mazzoli**. All right——

Mr. **Lynch** [continuing]. Under Mr. Hines——

Mr. **Mazzoli**. I appreciate that.

I'm sure that in a great success by E.F. Hutton you wouldn't divorce attention to, or you wouldn't claim to be a "bastard child," I think that, you know, concomitantly, if there is something wrong being done down below after all of this kind of attention, I would hope that you'd have some.

Anyway, Mr. Morley, you seem to be a guy on the spot here. How do you feel? Are you satisfied with what's been done, that you'd put your neck on the block right now?

Mr. **Morley.** I still—I think we are in the process of setting the controls up. I still think we have some more to do as far as centralizing the local relationships, but I am confident that we have in place now a mechanism to ensure everything is going on, and we will have an absolute foolproof in a very short period of time.

Mr. **Mazzoli.** I thank you, gentlemen.

I thank you, Mr. Chairman.

Mr. **Hughes.** I just want to say to my colleagues, I appreciate your spending what is an inordinate amount of time on a very complicated matter, and I appreciate the forebearance and the patience of the witnesses and those that are hear today. We have been at it a long time. I see some colleagues yawning, so it is time either to put them to bed or eat, and before we break I want to make a couple observations.

First of all, Mr. Castellano, I don't buy your suggestions that your office was not aware of the excessive overdrafting. The documents which we have, which we will get to after lunch, suggest otherwise.

To you, Mr. Fomon, I want to say that the documents that we've examined to date suggest, and we're going to supply you with some of them so you can take a look at them over lunch, that in fact there were people in the senior management that were aware of these practices, that the practices were encouraged. There is a great deal of pressure on the part of regions to comply with—for the central region, in particular, which was involved in excessive overdrafting, so there is an explanation for much of it.

I am not suggesting that, in a company your size, every region knew what every other region was doing, but I do suggest to you that, once you read the documents, I think that you'll have to agree that there were people in high places in your company that were aware of the excessive overdrafting. Overdrafting, to me, suggests that you're taking funds that don't belong to you.

Mr. Castellano, you had to submit a number of reports to the SEC, and also to your stockholders, financial statements. You had to reconcile, from time to time, those figures, and when you have to reconcile $400 to $450 million in drafts and checks payable, and try to explain that to the SEC, you've got to be on notice that something's wrong. And that's precisely what happened throughout this entire period of time, and I might say that the overdrafting continued beyond the time that you've testified, and, in fact you stopped the practices. So we're going to furnish you with those documents. You can take a look at them, in particular the documents from Linda Curtiss that was referred to today, which I gather you had never heard of before.

So we'll furnish you with that. Take a look at that, because I think that's extremely relevant to the testimony you've given today.

With that, the subcommittee stands adjourned until 2:15.

[Whereupon, at 1:11 p.m., the subcommittee was recessed, to reconvene at 2:15 p.m., the same day.]

AFTERNOON SESSION

Mr. Hughes. The Subcommittee on Crime will come to order.

Before we broke for lunch, I made reference to a memorandum directed to Mr. Ball, Bob Eber, Paul Hines, and it looks like "Peter"—it's very difficult to read the last name—"Maratote," perhaps——

Mr. Lynch. Muratore.

Mr. Hughes. M-a-r-a-t-o-t-e?

Mr. Lynch. M-u-r-a-t-o-r-e.

Mr. Hughes [continuing]. From Linda Curtiss, dated November 20, 1981. And I would like to offer this for the record.

Is there objection?

[No response.]

Hearing none, it is so admitted.

[The information follows:]

E.F. Hutton Interoffice Memorandum

To: George Ball, Bob Eber, Paul Hines, Peter Muratore.
From: Linda Curtiss.
Date: November 20, 1981.
Subject: Midwest region planning meeting.

Outlined below are the major issues, as I see them, surrounding the Midwest Region Planning Meeting to be held on Tuesday, November 24.

I. SALESFORCE, REVENUE AND PROFIT PROJECTIONS

Based on results through September of 1981, the retail offices of the Midwest Region are on track to finish the year with 437 AEs (5% higher than projected), $57.6 million in gross revenues (4% lower than projected) and $13.5 million in net profit (6% higher than projected). Thus, profits have the potential to increase by 4% over 1980 levels, despite a $1.5 million increase in the Midwest regional interbranch allocation to retail branches.

	AE's	Gross revenue	Net profit
1981 projection	416	$60,191,000	$12,680,000
1981 actual (9 mo annualized)	437	57,617,000	13,454,000
Percent difference from projection	+5.0	−4.3	+6.1
Percent increase over 1980 actual	+17.2	+8.5	+4.2

Attrition levels in the Midwest Region have increased dramatically during the first six months of 1981 to an annualized rate of 15%, up from an historical rate of only 10%, but still slightly below the firmwide 1981 rate of 16%. The region added 24 AEs from other firms during the first half of the year, an annualized affiliation rate of 11.5%, down from an historical level of 15%. Training slots are being filled as rapidly as they become available, with the region overfilling their first half year's allocation.

With affiliations, terminations and trainees at their recent historical rates, and with a similar market environment, the Midwest Region can expect to increase revenues by 16% in 1982.

Projected growth in the salesforce through 1985 (discussed at last year's meeting) is at an annually compounded rate of over 10%, slower than growth in the past five years, but nearly double the growth in the industry over the past five years.

EFH VERSUS INDUSTRY REPRESENTATION, MIDWEST REGION

	1980	1985 estimate	Compound growth rate, percent
EFH midwest AE's	573	616	10.3
NYSE midwest RP's	5,418	7,081	5.5
EFH share of NYSE PP, percent	6.9	8.7	4.7

II. PROFITABILITY

In brief, the Midwest Region has slightly higher than average productivity, direct costs equal to the firmwide rate, significantly better than average indirect costs, and the lowest relative interest profits in the retail system. This combines to a location profit level ranking 5th in the firm, slightly lower than average when measured on a per AE basis, or as a percentage of gross revenue.

REGIONAL REVENUE AND EXPENSES, 9 MO 1981 ANNUALIZED

	Midwest	Firm	Midwest rank
Gross revenue per AE	$144,800	$142,900	5
Direct costs as percent of gross revenue	41.2	41.2	5
Indirect costs per AE	$34,500	$35,900	2
Net interest as a percent of gross revenue	14.9	16.8	9
Location profit per AE	$72,100	$72,300	5
Location profit as a percent of gross revenue	49.8	50.6	5

The overall productivity of the Midwest Region's AEs, while slightly higher than the firmwide average, is below the experience-weighted "expected" level for the region, for full-time, retail AEs. The region has a slightly more experienced salesforce than the national average, predominantly due to the small population of AEs registered less than 3 years.

DISTRIBUTION OF MIDWEST REGION PRODUCTIVITY BY EXPERIENCE LEVEL, 6 MO 1981

	Full-time, retail AE's registered:			
	0–3 yr	3–7 yr	Over 7 yr	All
Percent of AE population:				
Midwest	23.4	25.7	50.9	100.0
Retail firm	27.9	23.1	49.0	100.0
Expected revenue per AE	$70,800	$141,300	$202,300	$155,800
Actual revenue per AE	$73,400	$135,000	$182,200	$145,600

This below-expected productivity, given the experience levels of the salesforce, is evident in 12 of the region's 18 established offices (67%) and ranges from 1% below expected in Madison to 31% below expected in Rockford.

Product strength in the region covers such diverse products as tax shelters (where the region leads the firm in actual and average production), life insurance, corporate bonds, and commodities.

Net interest profits in the Midwest Region are at the lowest level in the firm through the first nine months of this year, at 14.9% of gross revenue versus a firmwide average of 16.8%. This lower-than-standard interest is evident both in the interest earned on general ledger balances (indicative of cashiering operations) and in nterest earned on customer balances. Had interest levels been at the firm average for the first nine months of the year, the profits of the region could have been increased by $800,000 (an annualized $1.1 million). A one-month analysis of interest lone in the month of October, 1980 (admittedly old information, but inciteful noneheless) shows improvement potential in several areas: margin debit balances averaged 12% below the firm and the average spread charged on these balances was

10% below the firm; interest earned on overdrafting was 67% below average; interest earned from BOA checks and other general ledger balances was 20% below standard; interest from free credits was slightly better than average and interest on short sales only slightly below standard, but interest charged to the region because of cash debits was over 50% higher than average. In the past year, the region has made several attempts to remedy this interest situation, but current results versus the firm average (3rd quarter 1981) show a widening of the disparity in the cashiering-related interest on general ledger balances, while interest on customer balances has improved to the firmwide average.

NET INTEREST PROFIT AS A PERCENT OF GROSS REVENUE

	Interest on general ledger balances	Interest on customber balances	Total
4980:			
Midwest	3.5	6.5	10.0
Retail firm	4.1	6.9	11.0
9 months, 1981			
Midwest	5.5	9.4	14.9
Retail firm	6.8	10.0	16.8
3d quarter, 1981:			
Midwest	4.6	12.7	17.2
Retail firm	7.8	12.7	20.6

III. THE MIDWEST MARKET

The Midwest Region is the most under-brokered area of the country with 437 potential clients per NYSE registered representative, 43% more than the nationwide average of 306. However, the industry population is growing at nearly the slowest rate in the nation, with the number of NYSE RRs increasing by 2.2% from 1979 to 1980, and at an annual rate of 5.5% over the last 5 years. With Hutton's salesforce growing at 10%, our share of the NYSE RR population is steadily increasing. New offices in Flint, Janesville, LaCrosse, and St. Paul (expected to open next month) will extend over coverage.

IV. MANAGEMENT

Pages 24 through 28 of the attached package provide additional information on the branch managers in the Midwest Region.

I believe this memorandum and the attached schedules cover the major issues facing the Midwest Region.

Attachments.

[Signed] LINDA.

cc: L. Broad
A. Dorec
R. Frugoli
P. Genin

INTRODUCTION

During the analysis relating to the Midwest Regional Planning Meeting, interest profits for the Midwest Region versus those of other regions became an issue of great concern. Corporate Development, therefore, agreed to analyze the components of interest income and expense.

The objectives of this analysis are twofold. The first objective is to analyze the regional differences in the components of net interest income, primarily to determine, statistically, the causes of the Midwest Region's below average interest profits in 1981. The second objective is to develop a prototype for the periodic reporting of net interest income.

Prior analysis has shown a similarity of results for interest profit on an annual basis compared with the results of a single month. Based upon these results, and given the volume of clerical effort necessary to analyze the components of net interest income on a regional basis, the month of November, 1981, was selected as a representative sample. Interest revenues and expenses were examined for the interest month of October 15 to November 14, which is reported on the November P&L. This analysis was restricted to the retail regions as reported on the Regional Profit and Loss Statement. It examines interest, statistically, from the retail region's perspective. It does not comment on EFH accounting procedures, nor does it examine the firm's cost of money, but it looks only at the interest the firm charges/credits to the region. It does not make any specific recommendations as to operational changes which might increase interest profits; however, it does call attention to areas where operational or procedural analysis is warranted.

For purposes of this analysis, interest profits are separated into three distinct areas:

a. Interest earned on margin balances
b. Interest earned on general balances
c. Interest earned on cash balances in customer accounts

This analysis utilized various sources of information already available. Sources for this analysis included:

November 1981, Regional Profit and Loss Statement.
November 1981, Business Unit Profit and Loss Statement.
MF-5 and R-1 Reports, November 1981.
Normal Interest—General Ledger Report.
Normal Interest List—Customers.
Type 1 Interest.
Interest Analysis on Customer Balances.
Quarterly Account Executive Commission Report [QUAECR].

II. ANALYSIS

A. *Overview*

Interest profits were evaluated in three distinct pieces: interest earned on customer margin balances, interest earned on general ledger balances, and interest earned on customer cash balances. A fourth component of net interest income is the adjustment to customer accounts predominantly for Cash Reserve Management. This interest charge, while it may signal opportunities for improvement in office management, does not have a significant effect on interest earned in the branch. Occasionally, when non-recurring adjustments to interest income are warranted, this component of interest will reflect those adjustments.

For the month of November 1981, interest profit for the retail system was at a level just over 13 percent of gross, with the Central Region performing at the highest level (16.4%) and the New England Region at the lowest level (10.9%).

SCHEDULE I.—NET INTEREST PROFIT AS A PERCENT OF GROSS REVENUE, NOVEMBER 1981

	Percent, gross revenue	Rank
Atlantic	14.0	5
Central	16.4	1
Midwest	11.9	8
Mountain	13.6	6
New England	10.9	9
Pacific North	14.3	3
Pacific South	14.2	4
South Central	15.7	2
Southeast	12.8	7
Retail firm	13.4	....

Schedule II, highlights regional variations in the components of net interest income relative to gross revenue.

Of particular note are the Central and South Central Regions:

For Central Region, disproportionately high interest on general ledger balances resulted from aggressive overdrafting procedures with several branches in the Washington, D.C. area. Moreover, unusually high adjustments reflect recompense to banks for prior period aberrations in banking policies.

Several prior-period adjustments to general ledger interest reduced the South Central's interest income for the month. The impact of these adjustments is displayed below:

SCHEDULE III.—SOUTH CENTRAL REGION EFFECT OF PRIOR PERIOD ADJUSTMENTS ON INTEREST PROFITABILITY

	As reported—		Reversal of prior period adjustments—	
	Gross revenue	Diff. from average	Gross revenue	Diff. from average
Net interest income as a percent of gross revenue	11.9	−11	15.7	+17
General ledger interest as a percent of gross revenue	3.0	−48	6.8	+3

With respect to interest income relative to gross revenue in the Midwest Region: 44% of Midwest's offices exceeded firm average.

Lansing and Gateway outperformed average in all the major components of interest.

Southfield's interest was slightly below average due to below average margin interest profit.

Minneapolis ranks near the bottom of the offices in the Region.

Schedule IV, below highlights these offices.

SCHEDULE IV.—MIDWEST REGION—SELECTED OFFICES ANALYSIS OF THE COMPONENTS OF NET INTEREST INCOME AS A PERCENT OF TOTAL GROSS REVENUE NOVEMBER, 1981

Office	Net interest income	Margin interest profit	General ledger interest profit	Interest on customer cash balance	Interest adjusted to customer accounts
F05 Lansing	27.2	1.8	16.9	9.2	0.7
F41 Gateway	16.0	2.2	3.4	10.5	(0.1)
F06 Southfield	12.9	0.3	5.0	8.9	(1.3)
F17 Minneapolis	6.3	1.0	3.7	1.8	(0.2)
Retail firm	13.4	1.6	5.8	7.1	(1.2)

B. Interest profits relative to product mix

For tax shelters annuities, and life insurance, payment policy requires that the branch act only as an intermediary between the customer and the escrow bank or the sponsor. Under this payment policy, checks are routed through the branch and these customer payments escape entry into the branch's general ledger. Several designing branch managers circumvent this policy by withdrawing funds from the customer's account and issuing a check drawn on the branch for the transaction. Thus, the branch earns interest on the "float." However, as a rule, the branch does not earn interest on the sale of these products.

Since the branch does not earn interest on the sale of these products, product mix is a partial determinant of interest profitability at the retail level. Therefore, in order to isolate differences from firm average directly attributable to interest from those attributable to product mix, interest profits relative to "interest-sensitive" revenues were examined. Interest-Sensitive Revenues, for purposes of this analysis, represent revenues from all products other than tax shelters, annuities and life insurance. Mutual funds and commodity sales, which are traditionally non-interest sensitive, were included in interest sensitive revenues. Focusing on the Midwest Region revenues from these products do not have a significant impact. However, for the other regions and for selected offices within regions, isolating mutual funds and commodity sales will alter the results of an analysis of interest relative to interest sensitive revenues.

When product mix is taken into account, the region interest picture changes.

The following schedule displays these regional differences.

SCHEDULE V.—EF HUTTON INTEREST AS A PERCENTAGE OF GROSS AND INTEREST-SENSITIVE REVENUE NOVEMBER 1981

	Net interest income as a percent of gross revenue		Interest-sensitive[1] revenue as a percent gross revenue		Net interest income as percent interest sensitive	
	Percent	Percent difference from average	Percent	Percent difference from average	Percent	Percent from average
Atlantic	14.0	+4.5	77.2	+2.4	18.1	+2.3
Central	16.4	+22.4	75.2	−0.3	21.8	+28.2
Midwest	11.9	−11.2	70.5	−6.5	16.9	−4.5
Mountain	13.6	+1.5	71.8	−4.8	19.0	+7.3
New England	10.9	−18.7	65.7	−12.9	16.6	−6.2
Pacific North	14.3	+6.7	80.0	+6.1	17.8	+0.6
Pacific South	14.2	+6.0	80.2	+6.4	17.7	0.0
South Central	15.7	+17.2	80.3	+6.5	19.7	+11.3
Southeast	12.8	−.5	74.7	−0.9	17.1	−3.4
Retail firm	13.4		75.4		17.7	

[1] Interest-Sensitive Revenue represents Revenues from all products other than tax shelters, annuities, and life-insurance.

Schedule VI segments the dollar impact of differences from firm average in interest profit as a percentage of gross revenue into that attributable to differences in product mix and that attributable to the components of interest profit.

The New England Region is 18.7% below firm average in interest relative to gross revenue. This represents a variance from the firm average of $90,000 of lower interest profit for the month of November ($1,080,000 annualized). Over 70% of this amount, however, is attributable to product mix.

The Mountain Region reported interest profit only slightly above firm average when measured as a percentage of gross.

Mountain's above average interest relative to interest-sensitive revenues was reduced by its product mix.

The Midwest Region is 11.2% below firm average in interest relative to gross revenues, incurring a $78,600 opportunity cost for November ($943,000 annualized) against potential interest profit. Of this amount, $49,000 (62%) is attributable to product mix and $29,600 (38%) attributable to variances from firm average in the components of interest profit.

Several noteworthy offices in the Midwest Region include:

Milwaukee's product mix had a significant impact on interest profits for their office.

Carmel reported a high concentration of interest-sensitive product sales and therefore below average interest profit relative to interest-sensitive revenues.

Kalamazoo and Southfield, with lower-than-average interest-sensitive revenues, reported above average interest profit relative to interest-sensitive revenues. However, they reported below average interest relative to gross revenue.

Troy and Chicago rank below average in interest profit relative to interest sensitive and gross revenues.

Schedule VII below displays these differences.

SCHEDULE VII.—MIDWEST REGION—SELECTED OFFICES DOLLAR IMPACT OF VARIANCES FROM FIRM AVERAGE NOVEMBER 1981

	Total interest profit		Variance attributable to product mix		Variance attributable to the components of interest profit	
	Percent total gross	Better (worse) than average	Interest-sensitive revenue percent total gross	Differences from average	Interest as percent interest-sensitive revenue	Better (worse) than average
F14 Milwaukee	14.4	$2,300	55.3	($8,500)	25.9	$10,800
F25 Carmel	14.2	900	91.0	2,700	15.6	(1,800)
F04 Kalamazoo	12.8	(800)	55.4	(5,100)	23.2	4,300

SCHEDULE VII.—MIDWEST REGION—SELECTED OFFICES DOLLAR IMPACT OF VARIANCES FROM FIRM AVERAGE NOVEMBER 1981—Continued

	Total interest profit		Variance attributable to product mix		Variance attributable to the components of interest profit	
	Percent total gross	Better (worse) than average	Interest-sensitive revenue percent total gross	Differences from average	Interest as percent interest-sensitive revenue	Better (worse) than average
F06 Southfield	12.9	(4,300)	72.4	(4,900)	17.8	600
F08 Troy	10.3	(9,800)	61.9	(7,800)	16.7	(2,000)
F40 Chicago	9.4	(24,800)	59.1	(18,600)	16.0	(6,200)
Retail firm 13.4	13.4		75.4		17.7	

C. The components of interest profits relative to interest sensitive revenues

Henceforth, this analysis will examine each component of interest income relative to interest-sensitive revenues. Schedule VIII examines the relative dollar impact on interest-sensitive revenue of a variance with the firm average. Notice, although several regions reported above average performance in total interest, they forgo potential interest revenues in at least one of the components.

For example:

Below average margin balances reduce the potential interest earnings of the Atlantic Region.

The Midwest Region earned $29,600 for November less than its potential. That is, assuming the Region earned interest at the firm average, it would have earned $14,800 more on margin, $18,500 more on general ledger and $11,100 more on customer cash balances. Conversely, the Region had fewer CRM adjustments than firm average which reduced the potential loss by $14,800 for the month.

1. *Interest Earned on Margin Balances.*—Customers who purchase securities on margin are charged a rate above the prevailing broker's call rate. This rate generally varies with the size of the average debit balance in the customer's account. The branch, and in turn the region, earns the spread between the call rate and the variable rate charged customers. Therefore, total interest profits on margin balances are dependent upon three factors:

a. the number of margin accounts
b. the average debit balance per margin account
c. the spread between the brokers' call rate and the actual rate charged.

Schedule IX compares the interest earned on margin accounts to regional differences in the relative number of margin accounts in the region. Additionally, it compares to the firmwide standard regional variations in average daily debit balance per margin account and in the spread charged to customers.

Across the retail firm, the number of margin accounts averaged 13.2% of the total active accounts. In November 1981, the brokers call rate changed three times, varying from 16.0% to 15.5% averaging 15.87%. The average customer was charged an additional of 1.2% above call for margin loans.

The South Central Region had a below average number of margin accounts, but its average daily margin debit balance per account was the highest in the firm. Additionally, the spread between the call rate and the actual rate was at the firm's average. The result was the highest interest earned on customer margin balances.

2. *Interest Earned on General Ledger Balances.*—Each branch earns interest income on all credit balances (i.e., liability accounts) in its general ledger and is charged an interest expense for all debit balances (i.e., asset accounts). Both the interest earned and the interest charged are at the prevailing broker's call rate.

In general, 65% of this interest represents interest profit generated on the float on customers' checks. Overdrafting the branch's bank accounts and interest earned on all other general ledger accounts compose the remainder. Schedule X displays this relationship as well as the regional variations in general ledger interest.

As previously noted, the Central Region engaged in aggressive overdrafting of the bank accounts of several offices. These offices received as much as four days float on their receipts. This aggressive overdrafting resulted in two offices Washington II (C18), Alexandria (C20), contributing nearly 51% of the region's interest income earned on overdrafting. Moreover, when interest earned on overdrafting was examined relative to interest-sensitive revenues for these offices, the results were astounding:

CENTRAL REGION, INTEREST EARNED ON OVERDRAFTING NOVEMBER 1981

	C18	C20	Central region	Retail firm
Interest on overdrafting as percent interest-sensitive revenues	61.3	291.4	13.3	2.3

Drawdown procedures in the Central Region deviate from those of other regions. The Washington II (C18), Baltimore (C17), Norfolk (C25) and Bethesda (C32) offices are drawn down by New York directly. Moreover, the regional concentration account and the Kansas City bank account are commingled. Therefore, the regional interest earned on overdrafting for all offices, other than those drawn down by New York, is credited to the Kansas City Retail office. Recently the Region changed its procedures—the Kansas and Regional concentrations are now separate. For the month of November, interest earned on overdrafting as a proportion of interest-sensitive revenues amounted to 15.4% for Kansas City.

In addition to the Central Region, the Atlantic, Mountain and South Central Regions surpass the firm average in interest earned on general ledger balances. Aggressive overdrafting supported the Atlantic Region's position, while the float earned on BOA checks buoyed the Mountain Region.

Both west coast regions reported below average interest on general ledger balances. Because BOA checks are drawn on a California bank, West Coast offices would necessarily benefit less from their use, as evidenced by the lower interest earned on customer payables. However, both these regions fall below average in interest earned on overdrafting as well.

The Midwest Region reported general ledger interest below the firm standard. While the interest earned on the use of BOA checks exceeded firm average, the Region reported below average interest earned on overdrafting.

Several noteworthy Midwest offices include:

Lansing and Rock Island stand out with exceptionally good performance. Both offices earned significantly above average interest on customer payables with Lansing also above average on overdrafts.

Ann Arbor reported below average interest on general ledger balances. It earned slightly more than the firm average on the use of BOA checks, but significantly below average on overdrafts.

For the Chicago offices, branch receipts are deposited directly into the regional concentration account. This precludes these branches from earning interest on the overdrafting of their bank accounts.

Schedule XII, below, highlights these noteworthy offices:

MIDWEST REGION—SELECTED OFFICES INTEREST ON GENERAL LEDGER BALANCES AS A PERCENT INTEREST SENSITIVE GROSS NOVEMBER 1981

	Interest earned on general ledger balances	Interest earned on overdrafting	Interest earned on customer payables	Interest earned on all other general ledger accounts
F05 Lansing	18.7	7.2	14.8	(3.3)
F16 Rock Island	16.0	3.0	12.9	0.1
F40 Chicago	6.2	0.0	5.2	1.0
F01 Ann Arbor	6.0	0.2	5.4	0.4
F41 Gateway	4.8	(0.4)	3.7	1.6
Retail firm	7.7	2.3	5.0	0.4

3. *Interest Earned on Cash Balances in Customer Accounts.*—A branch earns interest on free credit balances in cash accounts and on credit balances from short sales in Type 3 accounts. In addition, a branch is charged interest on debit balances in its customers' cash accounts. A branch may recoup a portion of this interest expense by charging various customers for a debit position in their cash account. This analysis examines the interest earned on short sales and free credit balances as well as the

interest charged to the branch on cash debit balances. However, the interest recouped was not considered because it is a relatively small amount, and because timing differences between charge and collection preclude the matching of income and expense.

Schedule XIII summarizes regional variations in interest on customer cash accounts.

The Atlantic, Pacific North and Pacific South Regions outperformed the average.

Only the Pacific North reported average or better-than-average interest in all three components of interest on customer cash accounts.

New England and Midwest earned less-than-average, with especially poor performance in interest on short sales.

a. *Interest Earned on Short Sales.*—The interest earned on short sales credits is dependent upon the number of short accounts and the average credit balance per short account. The number of short accounts averages 0.6% of the total active accounts for firm. Each short account has an average credit balance of $14,200.

Schedule XIV details this relationship for the regions.

With an average number of short accounts, the Atlantic and Pacific South regions reported better-than-average interest on short sales due to higher than average balances per short account.

Midwest ranked ninth in interest on short sales. It had a slightly less than average proportion of short accounts and maintained a significantly below average balance per account.

Of the offices in the Midwest Region:

Only Madison, Gateway and Ann Arbor surpassed the firmwide standard.

Traverse City had below average earnings on short sales, but a better than average balance per short account.

Fifteen Midwest offices with below average interest on short sales reported a difference with the firm standard of more than 50%.

b. *Interest on Free Credit Balance.*—Schedule XV highlights regional differences in interest earned on free credit balances by comparing the estimated average free credit balances per account to the relative number of "cash" accounts. "Cash" accounts represent the total number of active accounts less Type 2 accounts, or 86.8% of the retail firm's active accounts. On average, the estimated free credit balance per account for the firm was $464.

The Atlantic Region led the firm in interest earned on free credit balances relative to interest-sensitive revenues. The average free credit balance for the region was 25% above firm average. Contrasting Atlantic with the New England Region, shows the latter with nearly 5% more cash accounts than average, each with an estimated average balance nearly 27% less-than-average.

The Midwest region earned slightly more than the firm average interest on free credit balances. While the region has fewer "cash" accounts per active acount, the average free credit balance per account exceeded the firm average by nearly 2%.

In the Midwest Region:

The average daily free credit balance per cash account exceeded firm average in six (55%) of the offices with better-than-average overall performance in free credit interest.

Among those offices earning less-than-average interest on free credit balances, Detroit reported only slightly below average interest. This was the result of higher-than-average balances per account and less cash accounts than average.

c. *Interest on Cash Debit Balances.*—The Branch is charged interest on debit balances in cash accounts at the call rate. These interest charges and debit balances in cash accounts arise from: a prepayment of the proceeds of a sale, a late payment for securities purchased, or a debit balance arising following a customer's failure to pay for securities purchased or to deliver securities sold. The interest charges to branches on delinquent debit balances in customers' accounts and settled Type 1 shorts for items exceeding $40,000 are reduced 75% by the computer. This interest charge on debit balances was analyzed by comparing the regional differences in average debit balance per Type 1 account.

Interest charged on cash debit balances is small in relation to interest profit on customer cash balances. This charge ranges from $1.20 for the Pacific South Region to $8.60 for the Atlantic Region per Type 1 debit balance account, average $3.70 per account.

The Atlantic Region had especially high interest charged on its cash debit balances in November, 1981. This resulted from an exceedingly large one day cash debit balance in the Columbus office (A48). Excluding this debit charge, the average cash debit charge for the region would be reduced considerably from 4.2% to 2.4%.

III. DEVELOPMENT OF A PROTOTYPE FOR PERIODIC REPORTING

The rapidly changing nature of our business demands that our managers have the right tools with which to evaluate opportunities and to plan for the future. Interest profits contributed over 70% of net profit for the retail firm in 1981. Therefore, understanding and managing the components of interest profitability is essential to the profitability of the branch, the region, and the firm.

In response, we have designed a prototype for the periodic reporting of net interest income. This *Interest Profitability Report* not only consolidates current information, but presents it in a format that the manager may utilize to improve his own performance. Interest is measured relative to interest-sensitive revenues. This provides a comparative yardstick of interest profitability at the branch level. A sample of this Interest Profitability Report was prepared for the Midwest Region and may be found in Appendix A. Details for its preparation are found in Appendix B.

EF HUTTON INTEREST CHARGED ON CASH DEBIT BALANCES NOVEMBER 1981

	Interest charged on cash debit balances		Type 1 accounts with debit balances as a percent of "cash"[1] accounts		Estimated average debit balances per Type 1 debit account	
	Percent interest-sensitive revenues	Percent difference from average	Percent	Percent difference from average	Amount	Percent difference from average
Atlantic	4.2	(101)	35.7	2.6	8.60	(132.4)
Central	1.4	30	29.5	(15.2)	3.50	5.4
Midwest	1.7	15	34.4	(1.1)	3.20	(13.5)
Mountain	1.4	30	30.2	(13.2)	2.30	37.8
New England	0.9	5	38.5	10.6	1.50	59.5
Pacific North	1.2	40	42.2	21.3	2.20	40.5
Pacific South	0.8	60	42.2	(21.3)	1.20	67.6
South Central	1.4	30	26.6	(23.6)	3.40	8.1
Southeast	1.4	30	33.7	(3.2)	2.50	32.4
Retail Firm	2.0		34.8		3.70	

[1] "Cash" Accounts * * * of active accounts less Type 2.

E.F. HUTTON—MIDWEST REGION INTEREST ON CASH BALANCES IN CUSTOMER CASH ACCOUNTS, NOVEMBER 1981

	Interest on balances in customer cash accounts		Interest earned on short sales		Interest earned on free credit balances		Interest charged on cash debit balances	
	Percent interest-sensitive revenues	Percent difference from average	Percent interest-sensitive revenues	Percent difference from average	Percent interest-sensitive revenues	Percent difference from average	Percent-sensitive revenues	Percent difference from average
Offices Above the Firm Average:								
F01 Ann Arbor	14.8	55.8	2.1	10.5	13.1	36.5	0.4	80.0
F41 Gateway	14.6	53.7	2.9	52.6	0.2	37.5	1.5	25.0
F14 Milwaukee	13.7	44.2	0.8	(57.9)	13.8	43.8	0.9	55.0
F06 Southfield	12.3	29.5	1.4	(26.3)	11.7	21.9	0.8	60.0
F48 Flossmoor	11.0	15.8	0.2	(89.5)	11.6	20.8	0.8	60.0
F12 Madison	10.9	14.7	3.4	78.9	8.0	(16.7)	0.5	75.0
F04 Kalamazoo	10.9	14.7	0.4	(78.9)	10.7	11.5	0.2	90.0
F05 Lansing	10.1	6.3	0.5	(73.7)	10.3	7.3	0.7	65.0
F10 Rock Island	9.7	2.1	0.0	(100.0)	13.0	35.4	3.3	(65.0)
F08 Troy	9.7	2.1	1.7	(10.5)	8.6	(10.4)	0.6	70.0
Offices Below the Firm Average:								
F03 Grand Rapids	9.4	(1.1)	1.2	(36.8)	9.4	(2.1)	1.2	40.0
F22 Oakbrook	9.1	(4.2)	0.0	(100.0)	9.9	(3.1)	0.8	60.0
F07 Traverse City	8.4	(11.6)	0.9	(52.6)	8.2	(14.6)	0.7	65.0
F40 Chicago	8.4	(11.6)	1.0	(47.4)	10.4	(8.3)	3.0	50.0
F11 Wausau	7.9	(16.8)	0.2	(89.5)	8.2	(14.6)	0.5	25.0
F21 Flint	7.7	(18.9)	1.3	(31.6)	17.7	84.4	11.3	465.0
F02 Detroit	7.2	(24.2)	0.2	(89.5)	9.4	(2.1)	2.4	20.0
F20 Peoria	5.7	(50.3)	0.6	(68.5)	6.5	(32.3)	1.4	30.0
F45 Rockford	5.3	(44.2)	0.1	(94.7)	7.3	(24.0)	2.1	5.0
F30 Barrington	5.0	(47.4)	0.4	(78.9)	5.4	(43.8)	0.8	60.0
F25 Carmel	5.0	(47.4)	0.1	(94.7)	6.9	(28.1)	2.0	
F17 Minneapolis	2.3	(75.8)	0.7	(63.2)	2.9	(69.8)	1.3	35.0
F18 Janesville	1.8	(81.1)	0.0	(100.0)	3.5	(63.5)	1.7	15.0
Midwest Region	9.2	(3.2)	1.0	(47.4)	9.9	3.1	1.7	15.0
Retail firm	9.5		1.9		9.6		2.0	

Mr. **Hughes**. Mr. Fomon, what troubles me about this particular memorandum—and I'm going to ask you to comment after I make some observations about it, so that we can try to get some explanations, perhaps—is that this is in connection with the Midwest region planning meeting. The memorandum is directed to high management officials. Mr. Ball, I understand, was president of the operating company at that time.

Am I correct in that?

Mr. **Fomon**. Yes.

Mr. **Hughes**. Bob Eber was his assistant, as I understand it. What was his title?

Mr. **Fomon**. Well, he was——

Mr. **Lynch**. I think it was senior vice president, either at that time or shortly afterward.

Mr. **Hughes**. Of the operating company?

Mr. **Lynch**. Of the operating company.

Mr. **Hughes**. Did either one of them serve on the board of directors?

Mr. **Lynch**. Mr. Ball was on the board of directors.

Mr. **Hughes**. Mr. Ball was on the board of directors.

Mr. **Hughes**. Paul Hines, what was his position?

Mr. **Lynch**. Paul Hines was responsible for planning and control and for the basic accounting function, including the Corporate Development Group, which was headed by Linda Curtiss.

Mr. **Hughes**. And what was his title?

Mr. **Lynch**. Executive vice president.

Mr. **Hughes**. Executive vice president.

Did he serve on the board of directors?

Mr. **Lynch**. Not at that time.

Mr. **Fomon**. What are you talking about?

Mr. **Lynch**. Paul Hines.

Mr. **Hughes**. And Peter—is it "Muratore"?

Mr. **Lynch**. Muratore.

Mr. **Hughes**. Muratore, what was his position, area of responsibility and title?

Mr. **Lynch**. Senior officer for marketing.

Mr. **Hughes**. And he was a vice president, wasn't he?

Mr. **Lynch**. I believe a senior vice president at that time.

Mr. **Hughes**. For marketing?

Mr. **Lynch**. Marketing.

Mr. **Hughes**. Now we're talking about the timeframe 1979–82?

Mr. **Lynch**. Yes.

Mr. **Hughes**. The thing that troubles me about this particular memo, is that the analysis and overview deals with interest income, and in the course of the memorandum an effort is made to explain to these key management officials the differences between the regions and realizing interest income as part of gross revenue.

For instance, the comparison is made with the central region, which had a difference from the average of some 22 percent—22.4 percent, in comparison to the Atlantic region, whose difference from the average was 4.5 percent; the point being that central region, as well as other regions, for instance, as I see it, the New England region was even below the average by 18 percent and south central had a fairly good plus 17.2 percent above average for interest income. And the effort is made to explain the reasons for this disparity among the various regions.

And I am going to read you, at this point, what is stated in the memorandum. They talk in terms of:

> Each branch earns interest income on all credit balances by daily count in its general ledger, and is charged an interest expense for all debit balances, that is asset accounts. Both the interest earned and the interest charged are at the prevailing broker call rate. In general, 65 percent of this interest represents interest profit generated on the float on customers' checks, overdrafting the banks.
>
> The branches' bank accounts and interest earned on all other general ledger accounts compose the remainder. Schedule X displays this relationship as well as the regional variations in general ledger interest.

Then it goes on to observe:

> As previously noted, the Central Region engaged in aggressive overdrafting of the bank accounts of several offices. These offices received as much as four days float on their receipts. This aggressive overdrafting resulted in two offices, Washington, two at CNT, and Alexandria C20, contributing at nearly 51 percent of interest income earned on overdrafting. However, when interest earned in overdrafting was examined relative to interest sensitive revenues for these offices, the results were astounding.

Then it goes on to talk about a number of other aspects of operations in the various regions.

But I think that the critical area deals with a memo which was prepared for a regional meeting, which says, in essence, one of the ways to get up interest income and to bring the regions on a par is to do the same thing that they are doing in the central region. I can't read it any other way; can you?

Mr. FOMON. In retrospect, we know that this region was violating the firm's proper drawdown system.

Mr. HUGHES. Mr. Fomon, that wasn't my question, and you haven't answered the question.

My question, and I repeat it for you, is that I can't read this memo any other way than suggesting that "this aggressive practice of overdrafting by the central region is something that we should try to duplicate." That is what it says, in essence.

Mr. FOMON. That is correct.

Mr. HUGHES. This is an example——

Mr. FOMON. But no one writing this memo realized that what was happening in the central region was illegal.

Mr. HUGHES. What do you mean by——

Mr. FOMON. They thought that the other regions were not doing a proper job.

Mr. HUGHES. What is meant by "aggressive overdrafting"?

Mr. FOMON. Aggressive overdrafting is when you do not leave sufficient collected balances in a bank to compensate them for their services.

Mr. HUGHES. Well, that is the first time I've heard that explanation. I mean, overdrafting, to me, it means when you don't have money in your account, you draw a check for more than you have. I mean, that is what overdrafting means.

Mr. FOMON. There is nothing wrong with overdrafting. I thought I tried to explain that earlier. It is only when it's consistently overdraft. As long as it is not overdrafted on an average to leave average balances to compensate banks, there is nothing wrong with hat. That is what we talked, that is the way corporate banking is lone.

Mr. HUGHES. Are you saying that it is standard operating procelure for companies throughout this country to consistently overlraw their account?

Mr. FOMON. Not on an average basis; but there is nothing wrong vith overdrafting on a given day, so long as there are collected balances in the account that average out to a profit to the bank. There s nothing new about that. That's been——

Mr. HUGHES. I've never heard of any arrangement whereby that's a practice when the banks don't even know about it. I mean, one of the things that the banks are going to have——

Mr. FOMON. The banks do know about it.

Mr. HUGHES. The banks do not know about it, Mr. Fomon. Some of the banks audited your accounts because they got upset over the overdrafting on the balance. You had to make some settlements with some banks.

Mr. FOMON. Most banks do an account analysis, where they look at the average collected balances in the account over a period of time. So long as the average collected balances satisfy them, they are perfectly willing to let you overdraft on a day here and a day there.

Mr. HUGHES. Well, we're going to hear from the banks.

Mr. FOMON. Well, this is what you will hear from the banks.

Mr. HUGHES. We're going to hear from the banks. But some of the banks—as a matter of fact—were not only upset but some of the banks bounced your checks, some of the banks canceled your accounts.

In fact, the practice in the D.C. area, which is part of the central region, was apparently so egregious that one of your branch banks contacted another branch bank to complain about the practices that were giving, basically, Hutton and his operations a bad name. And——

I'm talking about the Hutton branch managers, not the branch banks. Let me correct that.

Mr. FOMON. I understand.

Mr. HUGHES. And the banks that we've dealt with thus far were unaware of the extent of the overdrafting that was done.

So, how can you suggest that it is acceptable practice as long as the banks——

Mr. FOMON. The situation that you are referring to in Washington, DC, was not part of our company approved drawdown system; it was in violation of E.F. Hutton's procedures and policies. It was egregious, it was terrible.

Mr. HUGHES. Let me ask you, was it company policy—was it E.F. Hutton policy—on November 20, 1981, to engage in aggressive overdrafting?

Mr. FOMON. There are many definitions of overdrafting. There's overdrafting on the company's books, overdrafting on the banks' ledger balances, overdrafting on the banks' collected balances.

Mr. HUGHES. Well, in what sense is Ms. Curtiss using the term "aggressive overdrafting?"

Mr. **Fomon**. Well, I would defer to Tom Morley or Mr. Castellano. I assume it refers to overdrafting on our own books, which, of itself, does not mean overdrafting on collected balances in a bank. Tom.

Mr. **Hughes**. Well, isn't there a direct relationship between overdrafting your own books and overdrafting a bank's ledger at the end of a day?

Mr. **Fomon**. I am told that there is not a direct relationship.

Mr. **Hughes**. Mr. Morley, can you shed some light on that?

First of all, how would you describe aggressive overdrafting? What does that mean, Mr. Morley?

Mr. **Morley**. I can't describe what Linda Curtiss means by aggressive overdrafting, I really don't know. I can tell you what overdrafting is in the term used by E.F. Hutton; it basically means using their authorized worksheet that tends to—and possibly could—end up with a credit balance on the books of E.F. Hutton but should not end up with an overdraft on the ledger balance of the local bank.

Mr. **Hughes**. Is applying the multiplier effect a part of overdrafting that was company policy in 1981?

Mr. **Morley**. Yes, sir.

Mr. **Hughes**. Was drawing down by the regional offices twice or three times what was deposited in the branch bank part of overdrafting and company policy in 1981?

Mr. **Morley**. The policy in 1981 was, the regional office would drawdown the local branch, just once, and deposit that amount of money into the regional account.

Mr. **Hughes**. Well, it became a practice to drawdown more than once, did it not?

Mr. **Morley**. That practice, I believe, sir, that was an unauthorized practice.

Mr. **Hughes**. So, that was not company policy.

Mr. **Morley**. No, sir.

Mr. **Hughes**. Was it company policy to drawdown much more than was deposited? Was that company policy or not company policy?

Mr. **Morley**. The company policy would not drawdown and deposit unless the worksheet said—you had the multiplier effect on the worksheet.

Mr. **Hughes**. There appeared to be no question but that aggressive overdrafting as, apparently, then the practice in the central region, did encompass the practice of drawing down much more than was deposited. I mean, that is pretty obvious, isn't it?

Mr. **Fomon**. That is correct.

Mr. **Hughes**. You couldn't see—you couldn't develop the results that were very much in evidence by this report about the disparity between the regions, unless that were the case; isn't that so?

Mr. **Morley**. [Nodding affirmatively.]

Mr. **Hughes**. Wasn't there somebody in the company on notice that there had to be "something wrong in Denmark" for them to be developing that type of a track record?

Mr. **Fomon**. I don't think so. I think what the memo is pointing out was that other regions were not drawing down to the extent they should, they were leaving too much in the way of collected balances in the branches, to the detriment of E.F. Hutton.

In retrospect, sure, it should have been a signal that there was something wrong in the central region, that they were doing their banking dishonestly.

Mr. HUGHES. Mr. Castellano, I did not mean to ignore you.

When the financial data was prepared which had to account for all these drafts and checks that were outstanding, how would you describe that to the SEC when you filed your report?

Mr. CASTELLANO. Our focus reports?

Mr. HUGHES. Yes, your focus report.

Mr. CASTELLANO. Well, all checks and overdrafts are shown on a separate line called "drafts and checks payable" on the balance sheet. And this would include the balance outstanding in the zero balance checking account for vendors, the outstanding payroll checks, which is also based on a zero balance, and any outstanding or overdrafts on the companies' books of individual bank accounts in the regions or the branches.

Mr. HUGHES. I am going to offer for the record, if I might, an annual audited report form X-17A-5 and supporting documents dealing with the reconciliation for the period ending December 31, 1984. Is there objection?

[No response.]

Hearing none, it is admitted in the record.

[The aforementioned documents follow:]

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FACING PAGE

ANNUAL AUDITED REPORT
FORM X-17A-5
PART III

Information Required of Brokers and Dealers
Pursuant to Section 17 of the Securities
Exchange Act of 1934 and Rule 17a-5 Thereunder

SEC FILE NO.
8- 9202

REPORT FOR THE PERIOD BEGINNING 1/1/84 (MM/DD/YY) AND ENDING 12/31/84 (MM/DD/YY)

Filed as Confidential Information with the SEC

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

E.F. Hutton & Company Inc.

Official Use Only

FIRM ID. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS:
(Do not use P.O. Box No.)

One Battery Park Plaza
(No. and Street)

New York, (City) New York (State) 10004 (Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Michael P. Castellano (212) 742-3546 (Area Code — Telephone No.)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*
(Name – if individual, state last, first, middle name)

Arthur Andersen & Co.

(ADDRESS) 1345 Avenue of the Americas (Number and Street), New York, (City) New York (State) 10105 (Zip Code)

CHECK ONE:

☒ Certified Public Accountant
☐ Public Accountant
☐ Accountant not resident in United States or any of its possessions.

FOR OFFICIAL USE ONLY

* *Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption.*
See section 240.17a-5(e)(2).

SEC [illegible]

A reconciliation of the amounts reported herein to amounts reported by the Company on Part II of Form X-17A-5 filed with the Securities and Exchange Commission for the period ended December 31, 1984, is as follows (000's omitted):

	Part II of Form X-17A-5	Reclassifications	Additional Subsidiaries Consolidated	Financial Statements
Assets:				
Cash subject to immediate withdrawal	$ 30,513	$ 692	$ 5,044	$ 36,249
Amounts segregated under Federal commodity and other regulations	99,823	41,051	-	140,874
Securities purchased under agreements to resell	6,646,671	(6,163)	137,688	6,778,196
Securities, at market value	3,942,068	(21,900)	369,778	4,289,946
Receivable from clients	2,165,546	16,661	95,253	2,277,460
Receivable from brokers and dealers	1,502,231	9,153	4,486	1,515,870
Exchange memberships, at cost	4,950	(5,321)	371	-
Office equipment and leasehold improvements, at cost, net	152,499	-	1,751	154,250
Dividends and interest receivable	12,333	64,132	8,855	85,320
Other assets	251,889	(76,831)	1,948	177,006
	$14,808,523	$ 21,474	$ 625,174	$15,455,171
Liabilities:				
Bank loans	$ 1,158,213	$(402,587)	$ 76,216	$ 831,842
Drafts and checks payable	775	402,587	1,982	405,344
Securities sold under agreements to repurchase	7,545,041	26,726	174,080	7,745,847
Securities sold but not yet purchased, at market value	2,296,080	-	9,696	2,305,776
Payable to clients	1,345,815	1,847	114,093	1,461,755
Payable to brokers and dealers	843,994	15,380	48,257	907,631
Accrued compensation	136,671	(57)	-	136,614
Dividends and interest payable	85,774	15	-	85,789
Income taxes payable	24,508	(116)	1,313	25,705
Payable to parent	571,711	(1,973)	192,800	762,538
Other liabilities	187,154	(15,707)	2,096	173,543
Subordinated liabilities	149,393	-	-	149,393
	14,345,009	26,115	620,533	14,991,737
Stockholder's equity	463,434	(4,641)	4,641	463,434
	$14,808,523	$ 21,474	$ 625,174	$15,455,171

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U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FACING PAGE
Information Required of Brokers and Dealers
Pursuant to Section 17 of the Securities
Exchange Act of 1934 and Rule 17a-5 Thereunder

ANNUAL AUDITED REPORT
FORM X-17A-5
PART III

SEC FILE NO
8- 9202

REPORT FOR THE PERIOD BEGINNING 1/1/83 (MM / DD / YY) AND ENDING 12/31/83 (MM / DD / YY)

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

E.F. Hutton & Company Inc.
(Filed as Confidential Information)

Official Use Only
FIRM I.D. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS:
(Do not use P.O. Box No.)

One Battery Park Plaza
(No. and Street)

New York, (City) New York (State) 10004 (Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Michael P. Castellano (212) 742-3546
(Area Code — Telephone No.)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*
(Name -- if individual, state last, first, middle name)

Arthur Andersen & Co.

(ADDRESS) 1345 Avenue of the Americas, (Number and Street) New York, (City) New York (State) 10105 (Zip Code)

1 CHECK ONE:

☒ Certified Public Accountant
10 SC NY ☐ Public Accountant
15 [illegible] ☐ Accountant not resident in United States or any of its possessions.

1 [illegible]

1 [illegible]

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Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See section 240.17a-5(e)(2).

SEC 1410 (1-84)

A reconciliation of amounts reported herein to amounts reported by the Company on Form X-17A-5, as amended, filed with the Securities and Exchange Commission for the period ended December 31, 1983, is as follows (000's omitted):

	Form X-17A-5	Reclassifications	Additional Subsidiaries Consolidated	Financial Statements
Assets:				
Cash subject to immediate withdrawal	$ 27,010	$ -	$ 4	$ 27,014
Amounts segregated under Federal commodity and other regulations	81,864	53,137	-	135,001
Securities purchased under agreements to resell	5,265,009	-	231,106	5,496,115
Securities at market value	3,336,829	(22,946)	48,663	3,362,546
Receivable from clients, net	1,836,318	11,098	3,652	1,851,068
Receivable from brokers or dealers	604,940	30,139	1,450	636,529
Exchange memberships, at cost	4,965	(5,414)	449	-
Office equipment and leasehold improvements, at cost, net	103,444	-	2,187	105,631
Dividends and interest receivable	17,788	66,485	4,379	88,652
Other assets	295,854	(132,499)	1,387	164,742
	$11,574,021			$11,867,298
Liabilities:				
Bank loans	$ 965,633	(419,193)	-	$ 546,440
Drafts and checks payable	4,100	419,193	12,676	435,969
Securities sold under agreements to repurchase	5,282,271	-	242,281	5,524,552
Securities sold but not yet purchased, at market value	1,992,685	-	3,732	1,996,417
Payable to clients	952,433	2,161	4,277	958,871
Payable to brokers or dealers	585,585	21,012	11,225	618,622
Accrued compensation	150,684	-	-	150,684
Dividends and interest payable	128,574	-	2,697	131,271
Income taxes payable	72,125	-	639	72,764
Payable to parent	753,736	-	15,555	769,291
Other liabilities	187,412	(23,973)	195	163,634
Subordinated liabilities	126,910	-	-	126,910
	11,202,148			11,495,425
Stockholder's equity:				
Capital stock and additional paid-in capital	25,916	-	-	25,916
Retained earnings	345,957	182	-	346,139
Cumulative translation	-	(182)	-	(182)
	$11,574,021			$11,867,298

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WASHINGTON, D.C. 20549

ANNUAL AUDITED REPORT
FORM X-17A-5
PART III

FACING PAGE
Information Required of Brokers and Dealers
Pursuant to Section 17 of the Securities
Exchange Act of 1934 and Rule 17a-5 Thereunder

SEC FILE NO.
8-3202

REPORT FOR THE PERIOD BEGINNING 1/1/82 (MM/DD/YY) AND ENDING 12/31/82 (MM/DD/YY)

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:
E. F. Hutton & Company Inc.
(Filed as Confidential Information)

Official Use Only
FIRM ID. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS:
(Do not use P.O. Box No.)
One Battery Park Plaza (No. and Street)
New York, (City) New York (State) 10004 (Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT
Michael P. Castellano (212) 742-3546 (Area Code — Telephone No.)

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INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*
(Name -- if individual, state last, first, middle name)
Arthur Andersen & Co.

(ADDRESS) 1345 Avenue of the Americas, (Number and Street) New York, (City) New York (State) 10105 (Zip Code)

CHECK ONE:

☒ Certified Public Accountant
☐ Public Accountant
☐ Accountant not resident in United States or any of its possessions.

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* *Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption.*
See section 240.17a-5(e)(2).

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SEC 1410 (4-78)

Securities and Exchange Commission's general instructions to Form X-17A-5. Under the Securities and Exchange Commission's general instructions, certain subsidiaries may not be consolidated.

A reconciliation of amounts reported herein to amounts reported by the Company on Form X-17A-5 filed with the Securities and Exchange Commission for the period ended December 31, 1982, is as follows (000's omitted):

	Form X-17A-5	Reclassifications	Additional Subsidiaries Consolidated	Financial Statements
Assets:				
Cash subject to immediate withdrawal	$ 22,047	$ -	$ 976	$ 23,823
Amounts segregated under Federal commodity and other regulations	88,268	65,819	-	154,087
Securities purchased under agreements to resell	1,942,989	-	97,086	2,040,075
Securities owned, at market value	2,124,307	(26,182)	18,750	2,116,875
Receivable from clients, net	1,137,514	14,355	1,114	1,152,983
Receivable from brokers or dealers	588,600	41,351	4,395	634,346
Exchange memberships, at cost	4,757	(4,757)	-	-
Office equipment and leasehold improvements, at cost, net	76,492	-	616	77,108
Dividends and interest receivable	18,984	29,590	625	49,199
Other assets	214,458	(117,230)	6,404	103,632
	$6,219,216			$6,352,128
Liabilities:				
Bank loans	$ 206,170	(146,170)	30,637	$ 90,637
Drafts and checks payable	2,041	146,170	-	148,211
Securities sold under agreements to repurchase	2,163,389	-	85,199	2,248,588
Securities sold but not yet purchased, at market value	1,374,490	-	-	1,374,490
Payable to clients	788,663	546	3,999	793,208
Payable to brokers or dealers	556,174	29,664	4,704	590,542
Accrued compensation	93,483	303	-	93,786
Dividends and interest payable	83,756	-	574	84,330
Income taxes payable	77,444	4,447	32	81,923
Payable to parent	371,854	-	-	371,854
Other liabilities	84,855	(32,014)	4,821	57,662
Subordinated liabilities	99,153	-	-	99,153
	5,901,472			6,034,384
Stockholder's equity:				
Capital stock and additional paid-in capital	25,303	-	-	25,303
Retained earnings	292,361	131	-	292,492
Cumulative translation	-	(131)	-	(131)
	$6,219,216			$6,352,128

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WASHINGTON, D.C. 20549

ANNUAL AUDITED REPORT FORM X-17A-5 PART III	FACING PAGE Information Required of Brokers and Dealers Pursuant to Section 17 of the Securities Exchange Act of 1934 and Rule 17a-5 Thereunder	SEC FILE NO. 8- 9202

REPORT FOR THE PERIOD BEGINNING 1/1/81 (MM / DD / YY) AND ENDING 12/31/81 (MM / DD / YY)

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

E. F. HUTTON & COMPANY INC.
(Filed as Confidential Information)

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FIRM ID. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS:
(Do not use P.O. Box No.)

One Battery Park Plaza
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NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Michael P. Castellano (212) 742-3546
(Area Code — Telephone No.)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*
(Name -- if individual, state last, first, middle name)

ARTHUR ANDERSEN & CO.

1345 Avenue of the Americas, New York, New York 10105
(ADDRESS) Number and Street City State Zip Code

CHECK ONE:

☒ Certified Public Accountant
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* *Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption.*
See section 240.17a-5(e)(3).

Securities and Exchange Commission's general instructions to Form X-17A-5. Under the Securities and Exchange Commission's general instructions, certain subsidiaries may not be consolidated.

A reconciliation of amounts reported herein to amounts reported by the Company on Form X-17A-5 filed with the Securities and Exchange Commission for the period ended December 31, 1981, is as follows (000's omitted):

	Form X-17A-5	Reclassifications	Additional Subsidiary Consolidated	Financial Statements
Assets:				
Cash subject to immediate withdrawal	$ 10,524	($ 1,427)	$ 2	$ 9,099
Amounts segregated under Federal commodity and other regulations	29,714	76,295	-	106,009
Securities purchased under agreements to resell	1,912,840	-	-	1,912,840
Securities owned, at market value	882,552	(18,510)	-	864,042
Receivable from clients, net	1,157,731	12,050	8,931	1,178,712
Receivable from brokers or dealers	493,493	33,668	1,215	528,376
Exchange memberships, at cost	4,451	(4,451)	-	-
Office equipment and leasehold improvements, at cost, net	60,044	-	661	60,705
Dividends and interest receivable	9,753	37,697	-	47,450
Other assets	217,509	(136,194)	5,364	86,679
	$4,778,611			$4,793,912
Liabilities and stockholder's equity:				
Bank loans	$ 546,781	($330,397)	$6,194	$ 222,578
Drafts and checks payable	1,991	330,397	2,359	334,747
Securities sold under agreements to repurchase	2,193,840	-	-	2,193,840
Securities sold but not yet purchased, at market value	243,016	-	-	243,016
Payable to clients	501,139	111	2,898	504,148
Payable to brokers or dealers	434,017	7,012	3,738	444,767
Income taxes payable	67,096	2,926	-	70,022
Accrued compensation	60,643	-	-	60,643
Dividends and interest payable	38,014	-	-	38,014
Payable to parent	205,598	-	-	205,598
Other liabilities	61,552	(10,921)	1,024	51,655
Subordinated liabilities	105,195	-	-	105,195
Total liabilities	4,458,882			4,474,223
Capital stock and additional paid-in capital	25,303	-	-	25,303
Retained earnings	294,346	181	(40)	294,487
Cumulative translation	-	(181)	-	(181)
	$4,778,611			$4,793,912

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549

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Information Required of Brokers and Dealers
Pursuant to Section 17 of the Securities
Exchange Act of 1934 and Rule 17a-5 Thereunder

ANNUAL AUDITED REPORT
FORM X-17A-5
PART III

SEC FILE NO
8- 2202

REPORT FOR THE PERIOD BEGINNING 1/1/80 (MM/DD/YY) AND ENDING 12/31/80 (MM/DD/YY)

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

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(Name -- if individual, state last, first, middle name)

ARTHUR ANDERSEN & CO.

(ADDRESS) 1345 Avenue of the Americas (Number and Street), New York, (City) New York (State) 10105 (Zip Code)

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R-11223

(2) Reconciliation of assets, liabilities and stockholder's equity to the regulatory report and net capital of guaranteed subsidiaries:

The financial statements have been prepared on the basis of generally accepted accounting principles and differ in certain respects from the accounting prescribed by the Securities and Exchange Commission's general instructions to Form X-17A-5. Under the Securities and Exchange Commission's general instructions, certain subsidiaries may not be consolidated.

A reconciliation of amounts reported herein to amounts reported by the Company on Form X-17A-5 filed with the Securities and Exchange Commission for the period ended December 31, 1980 (in thousands), is as follows:

	Form X-17A-5	Reclassifications	Additional Subsidiaries Consolidated	Financial Statements
Assets:				
Cash subject to immediate withdrawal	$ 5,427	$ -	$ 307	$ 5,734
Amounts segregated under Federal commodity and other regulations	105,699	90,216	-	195,915
Securities purchased under agreements to resell	1,742,714	-	-	1,742,714
Securities, at market value	930,208	(30,976)	-	899,232
Receivable from clients, net	1,156,686	12,268	2,745	1,171,699
Receivable from brokers or dealers	166,214	11,933	18,579	196,726
Exchange memberships, at cost	4,451	-	464	4,915
Office equipment and leasehold improvements, at cost, net	39,479	-	480	39,959
Dividends and interest receivable	5,610	13,402	-	19,012
Other assets	172,887	(116,843)	10,585	66,629
	$4 329,375			$4,362,535
Liabilities and stockholder's equity:				
Bank loans	$ 650,940	($345,856)	$ -	$ 305,084
Drafts and checks payable	5,225	345,856	13,555	364,636
Securities sold under agreements to repurchase	1,750,655	-		1,750,655
Securities sold but not yet purchased, at market value	325,809	-	-	325,809
Payable to clients	582,400	375	11,183	593,958
Payable to brokers or dealers	421,261	10,047	1,160	432,468
Accrued compensation	-	61,087	-	61,087
Income taxes payable	59,401	-	514	59,915
Payable to parent company	-	58,980	-	58,980
Other liabilities	193,896	(130,489)	6,828	70,235
Liabilities subordinated to claims of general creditors	94,638	-	-	94,638
Total liabilities	4 004,305			4,117,465
Capital stock and additional paid-in capital	25,303	-	-	25,303
Retained earnings	219,687	-	-	219,687
	$4,329,375			$4,362,535

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ANNUAL AUDITED REPORT
FORM X-17A-5
PART III

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Information Required of Brokers and Dealers
Pursuant to Section 17 of the Securities
Exchange Act of 1934 and Rule 17a-5 Thereunder

SEC FILE NO.
8-9202

…RT FOR THE PERIOD BEGINNING 1/1/79 (MM/DD/YY) AND ENDING 12/31/79 (MM/DD/YY)

A. REGISTRANT IDENTIFICATION

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1345 Avenue of the Americas, New York, New York 10019
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R-11230

(3) Reconciliation of assets, liabilities and stockholder's equity to the regulatory report and net capital of guaranteed subsidiaries:

The financial statements have been prepared on the basis of generally accepted accounting principles and differ in certain respects from the accounting prescribed by the Securities and Exchange Commission's general instructions to Form X-17A-5. Under the Securities and Exchange Commissions's general instructions, certain subsidiaries may not be consolidated.

A reconciliation of amounts reported herein to amounts reported by the Company on Form X-17A-5 filed with the Securities and Exchange Commission for the period ended December 31, 1979, (in thousands) is as follows:

	Form X-17A-5	Reclassifications	Additional Subsidiaries Consolidated	Financial Statements
Assets:				
Cash subject to immediate withdrawal	$ 20,863	$ -	$ 476	$ 21,339
Amounts segregated under Federal commodity and other regulations	108,711	68,644	-	177,355
Securities, at market value	418,678	(18,849)	806	400,635
Receivable from clients	1,050,059	5,800	12,168	1,068,027
Receivable from brokers or dealers	143,812	7,049	52,717	203,578
Exchange memberships, at cost	3,999	-	483	4,482
Office equipment and leasehold improvements, at cost, net	29,258	-	540	29,798
Other assets	128,729	(62,644)	(2,172)	63,913
Liabilities:				
Bank loans	$ 409,747	($248,730)	$ -	$ 161,017
Drafts and checks payable	1,547	248,730	16,175	266,452
Payable to clients	496,673	-	12,842	509,515
Payable to brokers or dealers	352,984	14,095	13,652	380,731
Accrued compensation	-	36,011	-	36,011
Other liabilities	120,771	(50,247)	22,349	92,873
Stockholder's equity:				
Capital stock and additional paid-in capital	$ 25,242	$ 141	$ -	$ 25,383

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ANNUAL AUDITED REPORT
FORM X-17A-5
PART III

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Information Required of Brokers and Dealers
Pursuant to Section 17 of the Securities
Exchange Act of 1934 and Rule 17a-5 Thereunder

SEC FILE NO.
8-9302

REPORT FOR THE PERIOD BEGINNING 1/1/72 (MM/DD/YY) AND ENDING 12/31/72 (MM/DD/YY)

A. REGISTRANT IDENTIFICATION

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ARTHUR ANDERSEN & CO.

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R-11231

(2) Reconciliation of assets and liabilities to the regulatory report and net capital of guaranteed subsidiaries:

The financial statements have been prepared on the basis of generally accepted accounting principles and differ in certain respects from the accounting prescribed by the Securities and Exchange Commission's general instructions to Form X-17A-5. Under the Securities and Exchange Commission's general instructions, certain subsidiaries may not be consolidated.

A reconciliation of amounts reported herein to amounts reported by the Company on Form X-17A-5 filed with the Securities and Exchange Commission for the period ended December 31, 1970, (in thousands) is as follows:

	Form X-17A-5	Reclassifications	Additional Subsidiaries Consolidated	Financial Statements
Assets:				
Cash	$ 19,242	($ 4,400)	$ 3,946	$ 18,788
Amounts segregated under Federal commodity and other regulations	51,376	37,095	-	88,471
Securities, at market value	230,565	(10,463)	6,552	218,654
Receivable from brokers or dealers	94,152	8,313	35,672	138,137
Receivable from clients	876,776	4,620	15,461	896,857
Exchange memberships, at cost	3,450	(210)	394	3,634
Office equipment and leasehold improvements, at cost, net	22,372	-	220	22,592
Other assets	62,020	(31,510)	(961)	30,341
	========	=======	=======	========
Liabilities:				
Bank loans	$421,507	($84,297)	$ -	$337,210
Drafts payable	60,827	80,493	8,195	149,515
Payable to brokers or dealers	220,777	3,084	25,073	248,934
Payable to clients	250,832	(549)	24,811	275,094
Securities sold but not yet purchased, at market value	108,595	54	1,543	110,192
Accrued compensation	-	24,609	-	24,609
Other liabilities	76,262	(27,742)	1,662	50,182
	========	=======	=======	========
Liabilities Subordinated to Claims of General Creditors	$ 60,694	($ 215)	$ -	$ 60,479
	========	=======	=======	========

Mr. HUGHES. This particular document, which is for the period ending December 31, 1984, I presume was prepared either by your office or in concert with your office.

Mr. CASTELLANO. It is prepared by one of theirs under my supervision.

Mr. HUGHES. Your direct supervision.

Do you review these documents personally before they are released?

Mr. CASTELLANO. No, I note—when you say "personally," not every single document.

Mr. HUGHES. Well, this is a reconciliation. It seems to me it is not a usual, run-of-the-mill document. This is a reconciliation of Hutton's accounts for a period I think it is of about 7 years.

Mr. CASTELLANO. No.

Mr. HUGHES. Five years. I'm sorry. I'm sorry, I stand corrected. This is an annual report and it is for the period December 31, 1984, and it is a reconciliation both for purposes of your focus report as well as your financial statements, which, I presume, are released to stockholders.

Mr. CASTELLANO. Let me explain what this report is, sir. The regulatory reporting regulations for focus, which is a stock exchange regulation, says that you must file your focus report at year end, within 25 days—business days—after December 31. However, since year end is also audited, they allow an audited focus report to be filed within 60 days of year end, namely February 28. And in every year, when we file the focus report on the 25th business day, there are always reconciling items, and that is one of the prescribed schedules in the audited focus report, which is signed by Arthur Andersen, which is this report. So, this one is signed by Arthur Andersen, and what Arthur Andersen does is, they take the focus report that we submitted on the 25th business day at year end and then reconcile it to the audited focus report, which they are certifying, too.

Mr. HUGHES. Well, let me ask you, in particular, under liabilities is an item called "drafts and checks payable," part 2 of form X-78-5, the focus report that is filed with SEC, carries an amount of "$775,000." Under "financial statements," the figure that is carried for "drafts and checks payable" is "$405,344,000." Can you explain that difference?

Mr. CASTELLANO. Yes. When we file under 17-A-5, within 25 business days, we do not have all of the balance sheets analyzed. So, all of the credits are shown in bank loans and the 775 refers to just drafts payable—the $775,000.

Mr. HUGHES. Were they, in fact, bank loans?

Mr. CASTELLANO. No, not necessarily. Some of them are, in fact—400 million of them are, in fact—checks payable, which are different than bank loans.

Mr. HUGHES. That basically represents overdrafts——

Mr. CASTELLANO. It would represent——

Mr. HUGHES [continuing]. In large measure?

Mr. CASTELLANO. It would represent a lot of things. It would represent the balance outstanding in a zero checking account with all vendors. It would represent outstanding payroll checks——

Mr. Hughes. That would represent a very small portion of that, would it not?

Mr. Castellano. Oh, no. That would be in excess of $100 million.

Mr. Hughes. You're talking about a zero balance account?

Mr. Castellano. Yes, sir.

Mr. Hughes. With an excess of $100 million?

Mr. Castellano. Right. These are checks that we issue every day.

Mr. Hughes. Wouldn't part of those checks also be checks written to cover other overdrafts? Weren't you using the zero balance account—wasn't the company using the zero balance account—to cover, basically, overdrafts at the branch office level?

Mr. Castellano. Yes, it was. That would be another piece of it. And that would also be included in this number.

Mr. Hughes. So my question is, once again, a large measure of that $405 million represents overdrafts?

Mr. Castellano. Yes, it does.

Mr. Hughes. Now, wouldn't that put you on notice in itself that there is something "wrong in Denmark"?

Mr. Castellano. No, not necessarily. I mean, it is a $15 billion balance sheet, growing every year. Arthur Andersen has never raised it as an issue.

Mr. Hughes. Well, that is no excuse, that Arthur Andersen didn't raise it as a question. It is a most unusual item. I have very—you know, I am not a CPA; Clay Shaw is. But checks payable are, you know—is a most unusual entry to begin with, particularly in that dimension, $405 million.

Is there—are you suggesting that between the period of time that this X-17-A5 focus report was filed and the time the financial statement was prepared, that that much money basically represented a difference in checks and drafts payable, or, you know, what is—how can you account for the difference?

Mr. Castellano. No, that number, that $400 million, was included in the $1.4 billion, $1,458,000,000, and we reported it. Because, as I said, we don't have the breakdown of the balance sheet as of that date. We then go in and analyze what is the pieces of the bank loans, and then break out the drafts payable.

Mr. Hughes. Well, didn't it occur to you that that amount that was carried as drafts and checks payable increased substantially over the years?

Mr. Castellano. It didn't occur to me because, normally, as the company grows that number grows as well.

Mr. Hughes. Did the company grow by that dimension?

Mr. Castellano. The company, well, you would have to compare the $405 million to the year before.

Mr. Hughes. Do you have that figure, the year before?

Mr. Castellano. No, I do not, sir.

Oh, sorry. I do have it. The year before, drafts and checks payable was $435 million.

Mr. Hughes. How about 1982? 148?

Mr. Castellano. 1982, $148 million.

Mr. Hughes. Well, my time is up.

The gentleman from Florida.

Mr. McCollum. Mr. Chairman, I don't have the expertise or the research background to follow and pursue this particular line of questioning. I don't know if Mr. Shaw or the other gentlemen at the other end would like to pursue this line of questioning. I have other questions I would like to ask, but if there is dealing with the technical end of this memoranda, I would like to give them that opportunity while it is occurring.

Mr. Hughes. The gentleman from Kentucky.

Mr. Mazzoli. I think the only question would be, there is a jump in 1 year of $300 million in that account. I just wonder if that is explainable.

Mr. Castellano. Well, the year that it jumped $300 million, the balance sheet in total went from $6 to $11 billion. So, again, with a magnitude of numbers—the magnitude of numbers that we're dealing with of a company this size, it wasn't raised as an issue.

Mr. Mazzoli. I'm not that sharp in percentages. What would be the percentage of increase from 6 to 11, applying that percentage to $100 million?

Mr. Castellano. Well, 6 to 11 would be almost 100 percent, because it's 11.8 from 6.3.

Mr. Mazzoli. So, to account for $100 million, it would be what, $200 million rather than——

Mr. Castellano. This went from 148 to 435, so—well, 2½ times.

Mr. Mazzoli. I have no further questions, Mr. Chairman.

Mr. Hughes. I wonder if he could just tell us—which figure was used in reporting on the focus report?

Mr. Castellano. The audited focus report would be the final column called the financial statements.

Mr. Hughes. That's the figure that was reported to the SEC?

Mr. Castellano. Correct.

Mr. Hughes. And that is the figure that was reported to stockholders?

Mr. Castellano. Well, this is only the broker dealer. The stockholders would be the consolidated, including the other major subsidiaries. But by and large, most of that number would be included in the annual report.

Mr. Hughes. I see.

Does the gentleman from Connecticut wish to inquire?

Mr. Morrison. Yes, I have some questions.

Mr. Hughes. On this subject?

Mr. Morrison. Yes, I do.

It would be reasonable to assume that this $400 million figure which represents overdrafts at the time, December 31, 1984, that that is not an aberration, that is not something that just happened at year end, that is an ongoing condition; that something in the vicinity of $400 million would be what was on the balance sheet at any other given time during the year; is that correct?

Mr. Castellano. Yes, sir.

Mr. Morrison. So that what we are seeing here is essentially that one of your liabilities is outstanding checks at any given time representing almost something like 90 percent of the equity in your firm; is that right?

Mr. Castellano. Yes.

Mr. **Morrison**. I mean, it seems to me that we're making comparisons on the size of this particular liability. I think the place to look at it is, you know, does it represent what the capital of your firm is, not what the overall balance sheet is, $14 or $15 billion.

It seems to me like a commercial paper operation here, you are issuing these checks that are essentially never covered. We're just rolling this over and you've got an added kind of financing that is going on.

You've just financed to the extent of $400 million in overdrafts that you are borrowing from the banks; isn't that right?

Mr. **Castellano**. I am not responsible for the treasury function, and, therefore, cannot answer that. All I can answer is from an accounting standpoint, and from an accounting standpoint the $435 million on a $15 or $11 billion balance sheet at that time was not significant.

Mr. **Morrison**. Well, I don't know which of you two gentlemen I should ask, but what this seems to be, this is an ongoing, outstanding liability every day of the year. It's as if you decided to issue some kind of paper that you're selling to these banks to finance your operation. It's really like commercial paper. Maybe it turns around every day, or every 2 days, or every 3 days, but that is what—and you're not paying interest on it, that is the interesting part of issuing it this way rather than issuing it as a note. It's a piece of—a usual piece of commercial paper.

This is a basically free loan that you are getting from the banks; isn't that right?

Mr. **Castellano**. I can answer part of that, that is not a free loan and that a large portion of that is based on zero balance accounts. And there we have agreements with banks to compensate them with fees and service fees.

Mr. **Morrison**. What portion of the $400 million is the balance accounts?

Mr. **Castellano**. I don't have that detail with me, sir.

Mr. **Morrison**. You said earlier about $100 million.

Mr. **Castellano**. Well, $100 million just for the vendor and customer checks payable, but then there would also be payroll checks outstanding. And our payroll runs roughly $50 million a month, and at December 31, for all the checks that didn't clear as of that day, they would all be outstanding.

Mr. **Morrison**. But some substantial portion—you would say to the extent which this is a zero balance account, that that's a contractual arrangement, that that is the—whatever banking institution is handling your zero balance account understands that it's extending a line of credit of $100 million or some such amount of money in perpetuity that is going to roll over every day; is that what you are saying?

Mr. **Castellano**. Yes, I am.

Mr. **Morrison**. And is there a piece of paper that represents that agreement?

Banks don't usually loan $100 million without having a piece of paper they could sue on or collect on if you happened to go into bankruptcy.

Mr. **Castellano**. I can't answer that. That is not in my area. Perhaps——

Mr. **Morrison.** Could someone tell me here what piece of paper represents this $100 million line of credit?

Mr. **Morley.** Again, that line of credit is not established at $100 million, the zero balance account. We pay our customers. It is agreed upon that when the bank clears that check, we will wire them funds that day to cover the check clearing. Very rarely is there a loan involved in our zero balance activity.

Mr. **Morrison.** Hang on a second.

You're saying this is an end-of-day balancing out of the account. You cover the balance at the end of the day.

Is anything cleared at the end of the day? Is that what you're saying?

Mr. **Morley.** Anything that clears at the end of the day, the bank notifies us that day. We wire them the funds to cover the check clearing.

Would it help if I gave an example to clarify?

Mr. **Hughes.** Sure.

Mr. **Morrison.** Go ahead.

Mr. **Morley.** If a customer of ours sold securities and wants a check for the proceeds of the sale, we will give him a zero balance check for the proceeds of the sale. Now, at that point in time the check that we issue is recorded upon our books and records as a zero balance check outstanding. I think that is the category that Mr. Castellano was referring to.

The check, itself, is in the possession of our customer. If they decide to deposit it into the local bank and the check is cleared through the Bank of America, Bank of America will charge our account the day that that check is presented to them, at which time we have left a balance with them to anticipate our daily check clearing, and that covers the clearing of the check. The Bank of America or the zero balance bank does not usually extend us a loan on the check clearing.

So, in that interim between the issuance of the check until the local bank tells us that the check has cleared, it remains on our balance sheet as a zero balance check outstanding.

Mr. **Morrison.** Yeah, but there's something that doesn't jive there. I understand, if I look at 12 noon, that you may have issued a bunch of checks over here and you haven't had to cover them over there, but this is an ongoing business and there is a flow of checks through here, and it seems to me that on any given day as much should be clearing through—I mean, the flow is on the average of a certain period—it may vary with any given instrument, but on the average it is 2 days, 3 days, whatever it is. There shouldn't be an ongoing gap in this process unless you are putting out more and more uncovered overdrafts.

It is the only way you can have, not at any given time but over a period of time, can continue to have this gap, because why are the checks—here's your new checks today, what's going on with the checks that are clearing?

Mr. **Morley.** That's correct. The checks that you issue each day usually are in the same amount of the checks that you are clearing each day, unless there is a large check or something.

Mr. **Morrison.** So, that would suggest that you shouldn't have such a huge zero balance contribution to this $400 million unless that is the part of the balance that is feeding back into the system down at the bottom, which is covering another whole set of overdrafts.

Mr. **Hughes**. Would the gentleman yield to me?

Mr. **Morrison**. I would be happy to.

Mr. **Hughes**. Because I think the gentleman is right, and that is precisely what was being done, the zero balance account was being drawn down heavily at times to cover major overdrafts at the branch banks.

You would have, from time to time, to cover a branch bank, come up with $10 million for the branch. Who authorized that, for instance, who would authorize that in the company? Who would authorize a drawdown of that amount out of a zero balance account?

Mr. **Morley**. The zero balance accounts are maintained and controlled by the local branch.

Mr. **Hughes**. By the local branch.

Mr. **Morley**. Right. They have the zero——

Mr. **Hughes**. You have no centralized control over that?

Mr. **Morley**. The zero balance accounts that we are referring to as far as the advance reimbursement check?

Mr. **Hughes**. Yes.

Mr. **Morley**. That is controlled by the local branch. The zero balance accounts that we refer to from our customers are controlled centrally, by the accounting department.

Mr. **Hughes**. Will the gentleman yield further?

Mr. **Morrison**. Certainly.

Mr. **Hughes**. On January 18, 1982, Mr. Lucas, who is the vice president and manager of E.F. Hutton & Co., Inc., in the Grand Rapids, MI branch, was sent a letter by Mr. Gilreath, who is an officer of the Old Kent Bank & Trust Co. There the drawdown amounted to $76 million in overdrafts.

There is nobody at headquarters that had any controls over those types of drawdowns?

[Information follows:]

OLD KENT
BANK AND TRUST COMPANY
[illegible]

[illegible]

January 18, 1982

Mr. Leroy C. Lucas
Vice President and Manager
E. F. Hutton & Company, Inc.
250 Monroe, N.W.
Grand Rapids, MI 49503

Dear Bud:

As Ralph Garlick and I explained on Friday, we are disturbed with the way the E. F. Hutton account at Old Kent has been handled recently. The net investable balances on the account were negative $726,864 and negative $14,739,791 for the month of November 1981 and December 1981 respectively. These large average deficits are evidence of E. F. Hutton drawing on uncollected funds. Old Kent, as well as all other banks, accept deposited items subject to final payment by the drawee bank. We are not required to accept items drawn on uncollected funds, and no longer will.

Effective Monday, February 18, the account was placed on a collected funds status. I personally regret this move, Bud, as it will require daily attention on my part to determine whether or not to pay or return items. I nonetheless feel it is necessary given the handling of the account.

Enclosed is a debit against your account of $48,120.11 for account activity for the months of November and December. You should note the figure would have been $184,958.18 if our operations staff had not been told to manually locate the $76,971,419.08 item drawn on the U.S. Trust Company of New York which you deposited on December 23. Our collected balance and investable balance program operates using the availability schedules published by the Federal Reserve and our correspondent banks. Availability for U.S. Trust is two days, which you can confirm by checking the other three U.S. Trust items which you deposited in December. Our extra efforts reduced float on this item from five days (due to the holiday weekend) to one day. The machine generated analysis assumes a five day float, and we have adjusted it as follows:

Mr. Leroy C. Lucas
E. F. Hutton & Company, Inc.
January 13, 1982
Page Two

Net Investable Balance per analysis:	$-14,739,791
Plus 4 days float (76,971,419.03 ÷ 31 x 4)	9,931,796
Adjusted Investable Balance:	$- 4,807,995

The charge for activity is calculated as follows:

November: (726,864) * .1655 ÷ 360 * 30	$ 10,206.38
December: (4,807,995) * .16 ÷ 360 * 31	66,243.49
Total Charges	$ 76,449.87
Less Amount Debited by W. Waanders- (76,971,419 @ 13¼%)	$ 28,329.76
	$ 48,120.11

E. F. Hutton and Old Kent have enjoyed a mutually beneficial business relationship for many years, and we would like that relationship to continue. We will monitor the account closely for one month and if you continue to ask us to pay on uncollected funds, we will ask you to either deposit only checks related to your Grand Rapids operations or close the account.

Sincerely yours,

J. M. Gilreath

JMG/cn

cc: Mr. William T. Sullivan, Jr.
Vice President
E. F. Hutton & Co., Inc.
1 Battery Park Plaza
New York, N.Y. 10004

Mr. **Morley**. I wasn't aware of that drawdown, sir.

Mr. **Hughes**. I thank you.

Mr. **Morrison**. If I could just proceed just a bit further on this.

Mr. **Hughes**. Your time is about up.

Mr. **Morrison**. OK.

With respect to the part—leaving for a moment—I'm not convinced about the zero balance account, but assuming it is just my lack of understanding, the rest of the money that we are talking about, the other $300 million or whatever, this is the money that is being overdrafted up and down the system. Is that right? It is not coming out of a zero balance account, it is coming out of one of these other branch accounts.

Is that right, Mr. Castellano?

Mr. **Castellano**. Well, without having all of the details that make up that number, I would say that, by and large, you are right.

Mr. **Morrison**. And by and large, that means that from each and every one of these banks we've basically got a going line of credit, borrowing some amount of money. That sums up to this huge amount of money on the balance sheet.

Mr. **Castellano**. Again, to my knowledge what you are doing sounds——

Mr. **Morrison**. Mr. Fomon, do you understand it to be——

Mr. **Hughes**. Why don't you let the witness answer.

Mr. Castellano, go ahead and respond.

Mr. **Morrison**. I thought he had answered. I'm sorry, Mr. Chairman.

Mr. **Hughes**. No, he had not.

Mr. Castellano, do you want to respond?

Mr. **Castellano**. Again, this is the balance on our books. It is the overdraft that is shown on the company's books. What the balance is on the bank's books, what the overdraft is on the bank's books, again, we would have to go back to whether or not it was collected funds, you know, and into some of the details, as Tom Morley was trying to explain earlier.

Mr. **Mazzoli**. Would you yield for just one question?

Mr. **Morrison**. Surely.

Mr. **Mazzoli**. If I could I would wait for my regular time.

But in this whole tangled scheme of transactions, was ever a zero balance check, which is a very exciting and sexy term for a check that is just simply a rubber check, but do you ever use a rubber check to pay for a rubber check?

Mr. **Castellano**. I don't know the answer to that.

Mr. **Mazzoli**. Mr. Morley, do you ever pay a rubber check with a rubber check?

Mr. **Morley**. Not to my knowledge.

I think a bank would be insulted by your calling a zero balance check a rubber check.

Mr. **Mazzoli**. I'm insulted that the bank is insulted, so that makes us even.

The rubber check is one that isn't covered. My dad used to get rubber checks, I know something about them.

When he got a rubber check, that means a check that doesn't have money behind it.

Now, if you are covering a bad check with another rubber check or bad check—has that ever happened? Have you consciously taken what you call a zero balance check, which is a check that doesn't have anything behind it, have you ever taken a zero balance check to pay off a zero balance check? A check drawn on a fake account, is what it amounts to, or sort of a convenience account. A check drawn on that account, used to pay a check drawn on another convenience account?

Mr. **Fomon**. At no time did we ever write a check without funds in the bank to cover the check.

Mr. **Mazzoli**. A zero balance check is a check without funds.

Mr. **Hughes**. Will the gentleman yield to me?

Mr. **Mazzoli**. Certainly.

Mr. **Hughes**. I think the facts are rather clear that you were drawing down funds in the branch banks far in excess of the deposits from customers and other receipts. At the end of the day, whenever the branch manager reported in, you checked the bank to see what the bank ledger showed, then the branch manager would write a check from the zero balance account to make that account show a positive cash balance.

Now, even though you had an arrangement with that zero balance account, with Chemical and the other banks where you maintained a zero balance accounts, even though you had basically a line of credit, in essence what you were doing is using that zero balance account to cover bad checks.

And it was a circular flow, as my colleague from Connecticut has indicated, it was a rolling type of operation that amounted to over $400 million, in essence tantamount to an interest-free loan without the knowledge or consent of most of the banks involved except for the zero balance account; isn't that so?

Mr. **Lynch**. I think we described this on page 14 of the overview as part of the excessive drawdown system, because we say that in a number of instances Hutton personnel caused DTC's, depositary trust checks, to be issued in arbitrary amounts far in excess of those called for by the drawdown formula, and covered those large D.T.C.'s with branch reimbursement checks which were the equivalent of zero balance checks.

So, I think the answer is yes, that in the excessive drawdown area, which was not authorized by the firm, we were covering a Hutton excessive drawdown with a zero balance check.

Mr. **Hughes**. So, your answer to the gentleman from Kentucky is that no, they had a line of credit with a zero balance account and they used that account, that line of credit, to cover the branch bank and the overdrafts, the major overdrafts.

Mr. **Mazzoli**. If I understand correctly——

Mr. **Hughes**. Basically, it was an arrangement with the bank, that you could drawdown amounts—I don't know whether you had a limited amount, but arrangement with the bank—and you paid for that service to be able to draw on that account over a period of time.

Mr. **Fomon**. Right.

Mr. **Hughes**. And that is the only contractual arrangement that you have that I am aware of with the banks.

Mr. **Mazzoli**. Mr. Chairman, if I could just borrow my friend's time for a second more.

If I understand correctly, if at the end of a day a bank calls me and says, "Look, you're overdrawn," and I go rushing down there with cash money, they've got cash money to take care of my overdraft, so we're all even. The guy at the end of the day says, "You're overdrawn." I go rushing down with a check which is covered from another bank. They're OK.

The guy calls me at the end of the day and says, "Ron, you're overdrawn." I go running down there and I give them a check, I give them a check that has no funds at that time.

And maybe the deal with the bank is—which is part of the scam, probably—the deal with the bank is, tomorrow morning if I go down there, or if I do enough business in some other account or something, that check is covered, but at that moment, at that moment in time, you have a check-kiting operation. You've got a bad check paying for a bad check.

Now, am I wrong?

Mr. **Hughes**. Mr. Fomon.

Mr. **Fomon**. I don't think it is a bad check paying for a bad check.

Mr. **Morrison**. Mr. Chairman, if I could just try to ask him the question——

Mr. **Hughes**. And then your time is up.

Mr. **Morrison**. I appreciate that.

Mr. **Mazzoli**. I used some of it.

Mr. **Morrison**. No, it was almost gone before you started.

Isn't it essentially the case that the only thing behind these overdrafts is the equity of your company? Isn't that really what we are doing here?

You know, you're $463 million stockholders' equity here, and you're carrying what is essentially $400 million of liabilities that are more likely just IOU's issued on the value of your company than any other given thing. This is not—if you had no net worth down here, people wouldn't want to be carrying—wouldn't allow you if they found out about it—to have these kind of overdrafts, that this is really money being borrowed on the strength of the company as a whole, not on the value of that particular paper because at the moment you're presenting it that paper has no value, it is a future promise to pay, it is not covered. Just as the gentleman from Kentucky has said, at that moment you don't have funds on hand to pay that obligation, it is a promise to pay sometime in the future when this whole system works around; isn't that what it is?

Mr. **Fomon**. Well, I think that banks open zero balance accounts based on the financial stability of the deposits.

Mr. **Morrison**. But most of these liabilities are not in zero balance accounts, they are up and down the level of the little banks all over the country; $300 million, I guess it is, subtracting the estimated $100 million.

Mr. **Lynch**. I think the problem is, we don't know the breakdown of the $400 million. I don't think we came prepared to analyze it. I think that was a December 1984 balance, which was year end's, which, I think, was very high because of year end transactions. I remember that specifically at the end of last year.

I don't think Mr. Castellano—and I don't have a breakdown as to how much of that represents zero balance checks, how much of it represents overdrafts at the banks. So, it is speculation to——

Mr. Morrison. Well, for the education, just for that portion that isn't the zero balance account—and later when we investigate this further and you give us all the documents, we'll find out whether it's $10 million or $400 million—you're basically borrowing money from these banks. That's what you're doing. It's a loan program. You're selling them your paper involuntarily. Isn't that what you're doing?

Mr. Lynch. No. I think there are several issues. One, the drawdown system was designed to capture floats. So, to the extent that we drew drafts to capture a float, this is a legitimate purpose.

Two, as Mr. Fomon mentioned, you can have an overdrawn balance on your books but the bank, on its books, will have good funds and a collected balance, which, again, relates to the float. The zero balance checks used to pay clients, to pay vendors, for payrolls, is a legitimate practice.

I think in reviewing the statement at year end, there was no suggestion of anything improper or illegitimate. And remember, this is the end of 1984. The excessive drawdowns were ceased in 1982. We are not aware of any improper practices at this time. I believe it is legitimate, but I think we have to get more details, analyze it, and explain it. We just don't have the information available today.

Mr. Hughes. The gentleman's time is up.

Before I recognize the gentleman from Florida, I want to put into the record, if I might, a document from Kevin R. Mahoney, who is an assistant to Mr. Morley, as I understand it, regional operations manager, dated June 8, 1981, subject "Bank Account Analysis."

Is there objection?

[No reponse.]

Mr. Hughes. Let me just read, if I might—and it bears on your statement, Mr. Lynch, that these practices really were with the knowledge of parties of the banks involved, and so forth. And I'll read it as best I can. It is not a very good copy.

> The attached article extracted from Cash Magazine is a simple, yet comprehensible, explanation of bank account analysis. It will help you and the office managers in your region should you have any questions. If an office is overdrafting their ledger balance consistently—their ledger balance consistently—it is probably best not to request an account analysis.
>
> All other offices however, should be receiving an analysis and forwarding a copy to you or me. In addition to allowing an office to keep track of balance and service charges, the analysis will tell them if they are getting 1-day availability in their deposits, et cetera.

[The article follows:]

EFHutton
INTER-OFFICE MEMORANDUM

TO Regional Operations Managers

FROM Kevin O. Mahoney

DATE June 8, 1981

SUBJECT Bank Account Analyses

The attached article, extracted from "CASH" Magazine, is a simple, yet comprehensive explanation of Bank Account Analyses. It will help you and the Office Managers in your Region should you have any questions. If an office is overdrafting their ledger balance consistently, it is probably best not to request an account analysis. All other offices, however, should be receiving an analysis (and forwarding a copy to you or me). In addition to allowing an office to keep track of balances and service charges, the analysis will tell them if they are getting one-day availability on their deposits (if there is a big difference between the average ledger and collected balances, we may not be getting one-day availability on our deposits).

Sandra
Pls make
copy for you & Steve

FC 144 (REV. 9/79)

CASH

MARCH 1981
VOLUME 1 • ISSUE 6

Bank Account Analyses: Compensation Tools

by Kenneth L. Parkinson

One of the most common reports used by a corporation that is used as a basic building block of its cash management system is the *bank account analysis*. An account analysis is essentially a detailed profit and loss statement prepared by a bank for each customer, usually on a monthly basis.

While formats for presenting account analyses vary widely among banks, an account analysis should show average ledger and collected balances, a computed earnings allowance or credit on the average collected balance (less bank reserve requirements), and total service charges for non-credit activities such as balance reporting, deposits, paid items, funds transfers, and accounting services. The service charges may be translated into required balances. Analyses do not usually include balance requirements for credit lines, "intangible" bank services, or arrangements for double counting of balances. Such items may appear on an overal company summary.

The difference between average ledger and collected balances is the average daily float. For lockbox and depository accounts, dividing this average daily float by the average daily deposit gives the cash manager an idea of how many days, on average, these deposits are taking to clear through the banking system. When this calculation is done for all lockbox and depository accounts, the analysis provides an effective way for the cash manager to monitor his check clearance activities.

Earnings allowances, usually based on U.S. Treasury bill rates, vary greatly, ranging from unspecified "rolling" averages of 91 day T-bills to six month averages of the weekly auction rates to 91 day rates for the month as quoted in the financial press. Some banks will also itemize reserve requirements while others adjust the earnings allowance for it.

Service charges can be converted to equivalent collected balances by using the earnings allowance and reserve requirements:

$$\text{Collected Balances} = \frac{(\text{Service Charge})}{(\text{Monthly Earning Allowance}) \times (1\text{-Res. Requirement})}$$

For example, with a 10% earnings allowance and 16.25% reserve requirements, $1 of service charges is equivalent to $143.28 in collected balances.

Figure 1 is an illustration of a simplified account analysis statement. Both service charges and collected balance equivalent are shown. Not that excess balances are stated as *collected* balances, not *available* balances.

The mixture of service charge components varies significantly from bank to bank,

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Figure 1
Sample Accounty Analysis
(Average Daily Figures for the Month)

Balances:		
Bank Ledger Balance (Daily)		$11,000
Less: Float/Uncollected Funds		1,000
Collected Balance		10,000
Less: Fed. Reserve Requirements (10.25%)		1,025
Available Balance		$ 8,375
Earnings Allowance: (11.5% (.96%/month)		$ 80
Service Charges*		
	$ CHARGES	Collected Bal. Req.
Checks Paid 100 @ $.10	$10	$ 1,250
Deposits 5 @ .40	2	250
Checks Dep. 200 @ .05	10	1,250
Wire Trans. 5 @ 5.00	25	3,125
Acct. Mainten. @ 10.00	10	1,250
TOTAL	$57	$ 7,125
Net Profit (Loss) on Account ($80-$57)		$23
Excess Collected Balance Available to Support Credit Line or Intangible Services		$ 2,075
Excess *available* balances		$ 1,250

---

*At the above earnings allowance rate, $1 of service charge requires $125 in balances.

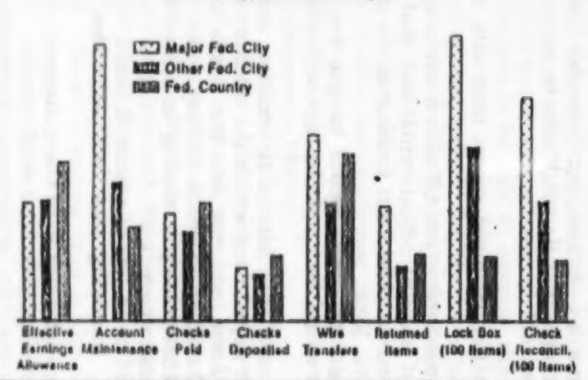
depending upon such factors as the individual bank's *method* of costing, the level of *detail* the bank is capable of identifying, and even whether the bank is in a Federal Reserve City or Country *location*. The degree of automation within the bank for capturing appropriate data will also affect the method of costing and, in turn, the mixture of service charge components.

There are a few charges that are fairly common to all analyses: per item charges for checks paid or deposited, monthly account maintenance charges for each account, outgoing wire transfers, and returned items. There are many charges, however, that may be peculiar to an individual bank or are not that common in occurrence; for example, FDIC assessment, incoming wire trasnfers, deposit ticket charges, account analysis preparation charge and volume rate differentials. Banks may also take different approaches to lockbox and check reconciliation charges; for example, high minimum charges with lower per item charges or low (or none) flat charges and higher per item charges. The differences in approaches make it difficult to compare one bank's charges with another's.

The computation of equivalent collected balances for service charges affords the opportunity to take into account differences in earnings allowances and reserve requirements and to compare costs of services from bank to bank. Figure 2 shows typical relative balance levels for several types of charges. These relative balances are the average charges among a sample of banks in each type of location — major Federal Reserve city (New York, Chicago, San Francisco), other Federal Reserve city, and Federal Reserve country. On the whole, the regional banks — other Federal Reserve city banks — seem to charge less than the major money center banks.

Account analyses can be used to establish effective target balances for each major bank by converting service charges to collected balances and then monitoring them relative to the average balances maintained at each bank. These targets should be average balances and can be monitored daily through the use of balance reporting systems or simple manual reports. In the latter case timing

Figure 2
Relative Collected Balances Required
To Support Service Charges



becomes critical. The longer it takes to receive balance reports from a bank, the longer it will take to establish and maintain target balances for that bank.

As more companies change their bank compensation method for non-credit services from balances to fees, the impact of the account analysis changes as well. The conversion of charges to collected balances is no longer relevant, and, assuming that the fees are equivalent to service charges, direct comparison of charges from bank to bank becomes appropriate. In this case, the important data in the analyses are the average balances. Arrangements can often be made to offset fee charges with excess balances.

The use of daily averages obtained from bank balance reporting systems can provide a timely snapshot as to whether balances are on target.

As Federal Reserve pricing charges hit the banks and are, in turn, passed along to bank customers, the need for effective compensation and target balancing tools will mushroom. More corporations will push for fee compensation and increased "price-shopping" will be inevitable. For the banks, the ability to identify the costs of services and price sensitivity of various types of customers will be the key factor in maintaining a profitable share of the corporate cash management services market.

331776

AGA Sponsors Study of Cash Management

The Association of Government Accountants (AGA) National Task Force on Cash Management, after two years of planning, has received final approval for a State of the Art Study of the cash management practices of Federal departments and agencies. The study will be conducted under the directorship of task force co-chairmen Daniel H. McGrath, Jr., deputy assistant commissioner, Bureau of Government Financial Operations, Department of the Treasury and John Lordan, chief, Financial Management Branch, Office of Management and Budget. Project leadership will be provided by Marshall D. Sokol, president, Marshall D. Sokol Associates Inc. and editor of CA$H.

The purposes of the study are to review the organization, practices and systems employed for cash management by Federal departments and agencies in order to ascertain what level of the state of the art has been accomplished to date, the opportunities for achieving greater control and productivity of cash flows and cash flow related information, and the resource requirements that would be necessary to take advantage of these opportunities.

All work on the study will be performed by task force teams composed of volunteers drawn from Federal departments and agencies, banking and other financial institutions, accounting firms, university faculties and corporate financial staffs. Anyone interested in contributing time and/or services to the furtherance of this study should contact Marshall Sokol, 914-997-0777, John Lordan, 202-395-6823, or Dan McGrath, 202-566-5922

Mr. **Hughes**. What is that saying to you, Mr. Morley?

I mean, this comes out of your shop.

Mr. **Morley**. I didn't see that when it was written, but in the course of the investigation I did come across that.

Mr. **Hughes**. That wasn't my question.

My question was: What does that mean to you? What is Mr. Mahoney saying; he's your man, isn't he?

Mr. **Morley**. I can't speak for him.

Mr. **Hughes**. He's saying, "Don't be dumb. Don't ask for a bank analysis if you're consistently overdrafting, because they're going to catch you." Isn't that what he's saying?

Mr. **Fomon**. That is what it says.

Mr. **Hughes**. How else can you explain that if that's not what it says?

Mr. **Morley**. Sir, I believe he is saying that, yes.

Mr. **Hughes**. The gentleman from Florida.

Mr. **Fomon**. May we have a copy of that?

Mr. **Hughes**. Yes.

The gentleman from Florida.

Mr. **McCollum**. I'd be glad to ask questions, but I wonder if Mr. Shaw has some specifics on this topic that he would like to ask.

If I might yield to you.

Mr. **Shaw**. Thank you.

Do you all have a copy of the annual audit report filed with the SEC?

I believe the chairman was questioning you off of it a while ago. It contains a certain number of account adjustments, and that is what I would like to question you on. And I am looking at the one for the period ended December 31, 1984.

And I assume, Mr. Castellano, that you would be the one to direct the question to, that you would be more familiar with these reports than anyone else.

I note, there, a cash balance as of that date of $30 million, and I note that you have an overdraft adjustment which the auditors extracted from the bank loan column and put into the drafts and checks payable column, of $402 million. Now, in looking down the account, it would appear that that money is resting in something other than cash. Could you tell me where it is?

Mr. **Castellano**. Well, it could be in lots of places. It could be in financing, customer securities, financing our own securities, it could be in——

Mr. **Shaw**. Where is it in the—let's use it in the statement that I'm referring to, and you tell me what account it might be in.

Mr. **Castellano**. They offset—could be in the securities purchase end year agreements to resale on the assets side, I'm looking at, sir.

Mr. **Shaw**. OK, so this clearly says that you have written checks on funds that you have in some type of negotiable securities that's earning interest for you, and that you do not have cash on hand at the time of this balance sheet to cover the amount of your overdraft; is that correct?

Mr. **Castellano**. Well obviously, we would not have the cash on hand, but most of the securities are very liquid, can be sold immediately.

Mr. **Shaw**. Oh, I understand that. I understand that, and they'd better be sold immediately, and they'd better be sold before those things get to the bank. But it would appear to me that you would have enough float that you could pretty much keep that thing floating pretty good for a period of time and continuing to hold—to draw interest.

I spoke to you about the statement of 1984. When you go back through the preceding statements, you find about the same figure in overdrafts except for the one year when it dropped way down. You see, they're all hovering between $300 and $400 million, which means it's a company policy to really hold that amount of liability. And you're pretty much counting on that much float, so that you know there's probably going to be enough to come in and to pick up the overdraft from the next day's business.

Is that not correct?

Mr. **Castellano**. Yes.

Mr. **Shaw**. I want to also, Mr. Lynch, ask you a question about the—you mentioned in your testimony, before we broke, that this money was—belonged to E.F. Hutton and it did not belong to the customer anymore. But I notice in here an account called Securities Sold but Not Purchased at Market Value.

Wouldn't it be fair to assume that a large amount of the cash that you have received, that's in these accounts, be contained in overdraft or, indeed, for the purchase of securities, that you are holding this in some kind of trust for the purchase of the securities for your clients?

Mr. **Lynch**. No. I think they are unrelated accounts. The point I made is that the confirmed bank accounts represent moneys owed by the company and the deposits made to those bank accounts and the float related to those accounts in effect are firm balances and not customer balances.

The accounts you mentioned, securities sold but not yet delivered, are the short sales of the company for its own account, in many cases in the Government bond area; so that we have an obligation to complete those transactions.

Mr. **Shaw**. Well, let me ask you this, then. If we're looking at securities purchased from agreements to resale, I assume that's the account that you are——

Mr. **Lynch**. No, I'm sorry.

Mr. **Shaw**. I assume that is the account you were referring to.

Mr. **Castellano**. He said "sold."

Mr. **Lynch**. I thought I heard you say "securities sold under agreements to repurchase" or "securities sold but purchased." I'm not sure which account we are looking at.

Mr. **Shaw**. Well, that is on the liability side. That is the one I referred to. But then I said—but then you referred to and I assumed you meant securities purchased under agreements to resell.

Mr. **Lynch**. No, in referring to an asset, I said that the money in bank accounts belongs to the firm. Generally it is money that they have received in payment of obligations and they've deposited to——

Mr. **Shaw**. Let me rephrase my question.

In order to show the liability under securities sold but not yet purchased at market value, in order to show it as a liability, I would assume you have been paid, otherwise it wouldn't be a liability.

Mr. Lynch. It is a liability because it hasn't been paid.

Mr. Shaw. I'm talking about has E.F. Hutton been paid.

Mr. Lynch. E.F. Hutton sold securities to a third party. The balance here represents the proceeds of that sale.

Mr. Shaw. The proceeds of the sale, which means that you received the money for the sale; is that correct?

Mr. Lynch. Not necessarily. If I delivered the securities to the other broker, I might——

Mr. Shaw. It hasn't been delivered, because it has not yet been purchased.

Mr. Lynch. No, it's a short sale, and if I had the securities available I might have delivered them and then paid against other securities. Typically, the other side of securities sold but not yet purchased is a fail to deliver, which would be a receivable from brokers and dealers. So, part of the $1.5 billion under receivables and brokers and dealers would normally be the other side of securities sold but not yet purchased.

Mr. Shaw. OK, but the other side of this equation happens to be the securities sold but not yet purchased. Market value is $2.25 billion, and the receivables from brokerages is only $1.5 billion. So, there's a spread there of $300—whatever—billion.

Mr. Lynch. No, I'm saying that to the extent the securities were not delivered and we didn't get paid, the other side would be a receivable from a broker dealer. So, some were delivered and some weren't.

Mr. Shaw. Do you agree with that, Mr. Castellano?

Mr. Castellano. Yes, sir.

Mr. Shaw. Well, where, once—could some of that balance be represented in the account called "Securities Purchased Under Agreement to Resell," which is shown here at over $6.5 billion?

Mr. Lynch. The securities purchased under agreements to resell is, to a large extent, related to securities sold under agreements to be purchased on the liabilities side. You'll see the balances are not far apart. The offset is $6.6 billion, the liability is $7.5 billion.

Mr. Shaw. All right, let me ask the question that I am trying to get to here. And I seem to—maybe I'm not asking the right questions, or maybe I'm getting the wrong answers; but E.F. Hutton is talking and I'm listening, but I'm not hearing the answer to the question.

There is a certain amount of overdrafts that has come in here. There's a certain amount of cash that is shown that has been received from customers, that is shown as a liability. And I want to know where that cash has gone. It would appear to me that it's gone into securities that E.F. Hutton is trading and holding on its own account with customers' money.

Is that correct or incorrect?

Mr. Lynch. No, I don't think you can do it that simply. The money received from bank loans, the money generated by drafts and the checks payable, the amounts payable to clients, the amounts payable to brokers and dealers, all get into the same mix. And you can't really say that money received on drafts and checks payable is used for any specific purpose.

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The simplest thing is that it would be used to reduce your overall liabilities; but you can't really identify it, because at the end of the day, if you have money left over to pay off a bank loan, if you are short you borrow money to make up the difference.

Mr. **Shaw**. Your bank account tells us that on that particular day you had over $400 million in overdrafts, only $30 million in cash, which means that you have received—which means that you have a negative cash balance of $360-some million, you owe these securities to customers, you have been paid for these securities; so, obviously, that money has to be resting in securities that are in the name of E.F. Hutton.

Is that correct or is that wrong?

If I am wrong, where is it; that's all I'm asking.

Mr. **Lynch**. Well, it's not—you can't specifically relate it to securities owned by E.F. Hutton. You have to look at it as part of the overall balancing of your cash on a daily basis. So, to that extent you receive more money than you pay out, you have money left over, you reduce your bank loans.

Mr. **Hughes**. Will the gentleman yield to me?

Mr. **Shaw**. I'll be glad to yield.

Mr. **Hughes**. I think what the gentleman is trying to find out—and I thought it was a rather simple question—is, where is the corresponding entry to cover the $405 million in drafts and checks payable on the assets side of the balance sheet?

Mr. **Lynch**. Maybe an example could help. If we draw the——

Mr. **Hughes**. Is that what the gentleman is trying to find out?

Mr. **Shaw**. That's right.

Mr. **Lynch**. If you draw a zero balance check to a customer, it means we owe the money at that point, which usually is for the proceeds of the sales. So, if the customer sold something, his account was credited with money on the settlement date. We do a zero balance check to him, cleared the balance in his account, and kept that zero balance check outstanding until it came to the central clearance account and was paid for.

So, I don't think you can trace $405 million, as such, to specific account balance sheets.

Mr. **Hughes**. Will the gentleman yield further?

If that is the case, then, shouldn't you have a corresponding entry on the asset side of your balance sheet which indicates accounts receivable?

Mr. **Shaw**. There is in that, but it's not——

Mr. **Hughes**. From clients of——

Mr. **Shaw**. Clients, brokers, and dealers. But what I am mainly concerned about——

Mr. **Hughes**. Is the liquidity.

Mr. **Shaw**. What I am trying to zero in on right now is securities sold but not yet purchased at market value. You received the money, you have not bought the security, otherwise it wouldn't be in this account, and you have a negative cash balance. And I'm just asking you where you put the money. I am trying to generate it from that account, not from that—I'm only using the overdraft account in that it very explicitly shows that you don't have the money anymore, that you've done something with it. I just want to know—where you—where it went. And I guess it's held in securities that you hold in your own name. If it's not, tell me where.

Mr. LYNCH. When you draw a draft payable—it does not, at that point, create money—it creates liability. And when you do that, you reduce an asset someplace. The example I gave you was reducing an amount in a customer's account and substituting it with a draft payable——

Mr. SHAW. Let me interrupt you. I want to ask Mr. Castellano——

At what point does a money figure get placed in securities sold but not yet purchased at market value, at what point?

Mr. CASTELLANO. At the point of trade.

Mr. SHAW. Does that mean you have received the money?

Mr. CASTELLANO. No.

Mr. SHAW. OK, then, where is the other half of that account?

Mr. CASTELLANO. If you sell something not yet purchased, that's basically selling a stock short.

Mr. SHAW. That would be——

Mr. CASTELLANO. Securities sold but not yet purchased.

Mr. SHAW. OK, is the other half of that account in receivables for clients?

Mr. CASTELLANO. Most likely in there.

Mr. FOMON. Or often brokers.

Mr. CASTELLANO. Clients or brokers.

Mr. SHAW. I yield back.

Mr. HUGHES. The gentleman from Florida.

Mr. MCCOLLUM. Thank you, Mr. Chairman.

I'm going to change the line of questioning slightly. I'm glad to have had the accounting lesson here today, I think it has been helpful and I appreciate it. But I would like to pursue something that has been left behind in all of this a little bit, and that is the chain of knowledge, once this matter was discovered in February 1982.

Mr. Fomon, you indicated this morning, I believe, that in February 1982, the general counsel brought to your attention this matter for the first time; is that correct?

Mr. FOMON. Yes.

Mr. MCCOLLUM. I would like to ask each of the other gentlemen when they learned and from whom they learned of this situation that led to the ultimate guilty plea.

Mr. Castellano, when and from whom did you learn that?

Mr. CASTELLANO. I was first informed there was a problem in May 1982, when I received a copy of a Telex that went out to the field, that there was a grand jury investigation.

Mr. MCCOLLUM. Until that time nobody had discussed this matter with you or raised a red flag in any way?

Mr. CASTELLANO. Absolutely not.

Mr. MCCOLLUM. And you had not caught anything that goes to your attention through the paperwork across your desk?

Mr. CASTELLANO. No, sir.

Mr. MCCOLLUM. Mr. Lynch, what about yourself, when did it first come to your attention?

Mr. LYNCH. About the first time that Mr. Fomon learned of it. I think I learned of it within a day or two.

Mr. McCollum. Who brought it to your attention?

Mr. Lynch. Mr. Rae, his general counsel.

Mr. McCollum. Was there a general type discussion?

Mr. Lynch. Yes, that we had a problem and it appeared to involve the multiple drawdown system in large checks that weren't clearing.

Mr. McCollum. Mr. Morley, what about yourself, when did it come to your attention?

Mr. Morley. The Genesee problem came to my attention. It was the second week in December.

Mr. McCollum. Of 1981?

Mr. Morley. Of 1981, correct.

Mr. McCollum. And how did it come to your attention?

Mr. Morley. I went to a meeting in Mr. Repsine's office, where the original operations manager in charge of the Atlantic region indicated that there had been a bank complaint and that they had—I believe he indicated they had returned or were returning some checks.

Mr. McCollum. Did you discuss this with anyone after that meeting between then and, say, February of the next year?

Mr. Morley. We discussed it at that meeting, but Mr. Epstein instructed the regional operations manager to stop.

Mr. McCollum. Stop the procedure?

Mr. Morley. Stop.

He had indicated that he had multiple transfers; in other words, going from one bank into another bank.

Mr. McCollum. Which region was this—the Atlantic region?

Mr. Morley. The Atlantic region.

Mr. McCollum. Was there a discussion of possibly any other regions being involved?

Mr. Morley. Pardon me, sir?

Mr. McCollum. Was there a discussion at the meeting of any other regions being involved?

Mr. Morley. No, sir, not to my knowledge.

Mr. McCollum. After that what was the next contact you had with this after that meeting?

Mr. Morley. There was a meeting with the State examiners.

Mr. McCollum. With whom?

Mr. Morley. The State examiners.

Mr. McCollum. Yes.

Mr. Morley. At which point they raised the problem, a complaint letter from Genesee Bank.

Mr. McCollum. When would that have taken place?

Mr. Morley. I believe that was in the early part of February.

Mr. McCollum. At that point in time, had you had any discussion, yourself, with the general counsel?

Mr. Morley. I had discussions with general counsel about preparing ourselves for the meeting wtih the State bank examiners, but we did not discuss—I did not bring up nor was it discussed—the Genesee problem.

Mr. McCollum. Did you think this was a pretty big deal when you came out of that meeting in December? Did it bother you?

Mr. Morley. It bothered me, yes, sir.

Mr. McCollum. Mr. Fomon, as big as this is, or turned out to be, and as bad for E.F. Hutton as it is, did it surprise you that you did not learn of this until 1982, when there was a meeting in December 1981?

Mr. Fomon. No; it does not surprise me, because no one in December realized how extensive this illegal practice was.

Mr. McCollum. I assume, at second guessing, that is true, but it isn't disturbing to you that nobody bothered to report it to you, even though it may have been only one or two incidences?

It seems to me that the possibilities were so great, that if I were in your shoes and I learned about it later, I would have been a little bit upset that nobody said anything to me before 2 months after the fact, if, in fact, there was such a meeting with as many people aware of it as apparently there were with this meeting that Mr. Morley and Mr. Epstein were attending.

Mr. Fomon. Well, maybe I should have been.

Mr. McCollum. But you weren't?

Mr. Fomon. Right.

Mr. McCollum. I want to put this in perspective, Mr. Chairman, before I yield back my time here.

Just in all fairness, my understanding is that at some point the guilty plea practices did stop—have stopped. At what point did that occur?

Mr. Fomon. Well, it occurred in the Atlantic region immediately, with the Genesee situation. And as soon as it came to our attention that it was more widespread, we stopped. That was, I think, in the spring.

Mr. McCollum. Of 1982?

Mr. Fomon. Yes.

Mr. McCollum. Did any of the practices, Mr. Fomon, to which Hutton has pleaded guilty, expose Hutton to any loss or jeopardize any customer funds?

Mr. Fomon. Absolutely not.

Mr. McCollum. There has been an indication that there has been—I should say there has been no indication here today that any of the management of the level of what you call senior management which, I assume, means the president, the chairman, the executive committee of the corporation, had any knowledge or involvement before the dates of 1982.

Is that essentially correct, or did——

Mr. Fomon. I have absolutely no evidence that they were aware.

Mr. McCollum. You don't know yet, of course, what Attorney General Bell's report might show to you, though; is that correct?

Mr. Fomon. Right.

Mr. McCollum. I am interested in one of the last questions. My understanding is that you're in the process of restitution right now and you have presented us quite an extensive list, a little book I have up here on that bank restitution package.

Is there a dollar limit on this or is E.F. Hutton going to pay whatever it turns out to be in full?

Mr. Fomon. No, there is no dollar limit. The press seems to think that the agreement with the Justice Department was an $8 million agreement. There is no limit on the agreement with the Justice Department.

Mr. McCOLLUM. So, it may be greater than that.

Mr. FOMON. Could be.

Mr. McCOLLUM. When all of it is said and done.

Mr. Chairman, I think I have asked enough, and I yield back. Thank you.

Mr. HUGHES. The gentleman from Ohio.

Mr. FEIGHAN. Thank you, Mr. Chairman, if I could just sort of follow up on the gentleman from Florida's question about whether or not illegal or inappropriate practices had been stopped.

The checks, of course, that we're talking about are checks that have coding at the bottom. Mr. Fomon, you are familiar with the encoding system on those checks——

Mr. FOMON. Yes.

Mr. FEIGHAN [continuing]. In a general sense, I'm sure. And the purpose of that encoding is to speed up the processing through the banks, and that is done electronically, of course.

If I were to submit to you a check and you presented it to your bank that day, and they were able to submit it to my bank that day, I would have a debit against my account. And they can speed it up that quickly because of the encoding procedure that they follow. But, of course, if I somehow had a check that was not properly encoded, then that check would have to be treated manually and that, of course, would delay the process.

Is that a fair characterization so far of what you understand?

Mr. FOMON. Yes.

Mr. FEIGHAN. I would have the advantage, of course, in that circumstance, to use that delay of a day or two to use that money for my own profit, in order to gain additional interest off of it.

You would say that that would be a fair characterization of what could happen?

Mr. FOMON. Yes.

Mr. FEIGHAN. In July 1980, Mr. Morley, along with Lou Malazzo, who apparently was Hutton's comptroller at the time, met with the Bank of America personnel to talk about the problems that they were having with miscoded checks. That was in July 1980. And there's a memorandum that we have, that you have submitted, from Bank of America indicating that they thought it was a very serious problem.

Were you aware of that problem as early as July 1980, extensive miscoding of E.F. Hutton checks?

[Information follows:]

MEMO ON CALL

COMPANY: E. F. Hutton & Company

CONTACTED: Thomas Morley, Vice President
Lou Malazzo, Controller

BANK OFFICERS: James H. Schuppert, Vice President
Rhonda Shores, Sr. Corp. Acct. Admin./CSC-South #1235

DATE: July 10, 1980

We met today to introduce Rhonda Shores to the new manager of bank relations at Hutton, Tom Morley, and to review several operational aspects of Hutton's accounts at the service center. The following areas were discussed.

-Check problems: Malazzo acknowledges the problems the poor check printing is causing our Service Center and his accounting department. Hutton's stationery & supply unit has found a new printer and checks are being ordered for all Hutton branches, beginning with those for which the non-read problem is the worst. The problem should be reduced by August and new checks should be in all branches by year end.

-Documentation: We raised the point that Tom Morley should be added to Hutton's corporate resolution in place of Bill Sullivan. This will enable Tom to empower others to sign on Hutton's accounts. We also discussed establishing a better procedure to ensure we are properly advised of any new authorized signers and particularly of any signatures which are no longer authorized.

-Vendor account: It was agreed that the new vendor concentration/funding account will be activated on Friday, July 11.

-Balance Reporting: Rhonda reviewed with Tom the daily balance reporting we do for the Hutton accounts. Tom now understands that information which we provide each day. Also, he understands that balances are required to compensate us for the activity on these disbursement accounts. Tom would like to review our analysis with us to ensure that all accounts appear. We should also review the year to date summary so Tom appreciates the "catch-up" position he is in relation to activity balance requirements.

JH Schuppert

James H. Schuppert
Vice President

JHS:km

Mr. **Fomon**. I was not aware of it until the last couple of months.

Mr. **Feighan**. Until the last couple of months of this year?

Mr. **Fomon**. Yes. But I don't know that it was substantial miscoding, I understood it had to do with one bank account. It was not a willful miscoding. As has been reported to me, we ordered checks. I understand the printer misencoded them. When it was brought to our attention, we reordered checks; and, unfortunately, they were misencoded again. However, this is secondhand information supplied to me by my legal counsel when I asked them about it.

Mr. **Feighan**. It was not in your view, as you said, substantial miscoding——

Mr. **Fomon**. All related to one bank, as I understand.

Mr. **Feighan**. Well, in May 1981, Chemical Bank told Hutton that it was having extensive problems with Hutton's miscoding of checks. Hutton responded in documentation that we have that that miscoding problem with Chemical Bank, the second major bank, would be cleaned up in 2 to 2½ weeks.

Were you aware of that?

Mr. **Fomon**. I think that is the one—that's the only one, I think, I am aware of.

Mr. **Feighan**. Well, rather than delay this, I would be happy to show you the documents from both Bank of America and Chemical Bank, that make reference to the meetings.

Mr. Morley is nodding his head, indicating that, in fact—

Are you indicating, Mr. Morley, that you are aware of the meeting that I refer to with the Bank of America officials in 1980?

[Information follows:]

☒ Customer ☐ RECEIVED

E.F. Hutton & Co., Inc.

SEP 14 1981

STEPHEN A LASERSON

Tom Morley, Treasurer
Kevin Mahoney, Ass't. Treasurer

☐ ☐ ☐

S.A. Laserson
N.L. Hollander
S.R. Harris

Corporate

14/6

August 26, 1981

Copies To	Name		Action	Copies To	Name		
Bank Investment				International Bank Group			
Corporate Bank Division 14	S.A. Laserson			Metropolitan Bank			
Corporate Trust Services				Operations Dept.			
Financial Systems				Other — Specify			
Executive Officer				Other — Specify			

SAL, NLH and the writer met with Tom Morley, Money Manager, to discuss the management of Hutton's accounts with Chemical. The relationship is not profitable at the present time. The Company has been running substantial uncollected balances and continuing overdrafts in certain accounts. We provided Morley with a listing of Hutton's 29 corporate accounts and a detailed analysis of the activity in the accounts presenting the more serious problems. A copy of the analysis is on file.

The following accounts/topics were discussed:

1. Account 610-660365 was uncollected $5.9 million in July and $14.3 million in 1981. Federal Funds wires are being sent out against Clearinghouse Deposits. A portion of these wires are being sent to Hutton's account at Manufacturers Hanover while checks are being deposited drawn on the Hutton account at Manufacturers. Checks are being written to Hutton accounts at other banks as well.

2. Overdrafts in zero balance account 610-661639 habitually exceed the afternoon clearings. (subsequent to our meeting, this problem was correct

3. Mis-encoded checks for account 610-663593 result in a one-day delay in charging the firm because debits must be posted manually. The firm first agreed to correct this problem last May, but to date it has failed to do so. Overdrafts averaged $9,622,000 in July and $6,111,000 in 1981.

modity Margin Certificates:

Hutton receives credit for the commodity margin certificates maintained with Comex, Coffee & Sugar Exchange or the Cocoa Exchange at Branch 24. These balances are generally in excess of $20 million. Account 066-013801 receives credit for these certificates and we permit the company to run uncollected balances up to $20 million in 066-020182. Therefore, we do not have a cost of funds associated with this arrangement. We do, however, hav a credit exposure. Furthermore, Hutton's deposits are not certified. Our exposure is 2 days when checks are drawn on this account and 3 days when funds are wired out. To mitigate our risk, we tell Morley that we should have deposits of certified checks. Hutton may prefer to give us collateral rather than deposit certified funds, but we do not agree to this alternativ as of this meeting.

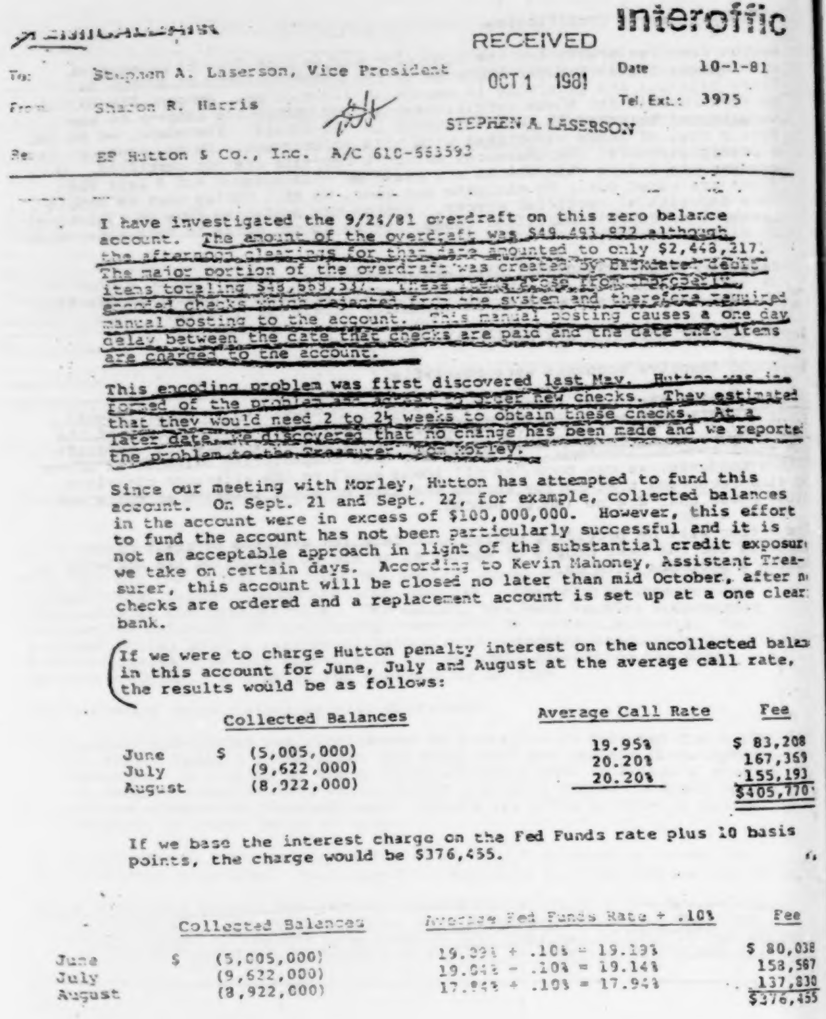
Lastly, account 066-013801 has been overdrawn or uncollected to a high of $9 million since 7/1/81. This figure added to the uncollected in 066-02018 is more than the $20 million in commodity margin certificates.

5. Five other accounts are habitually overdrawn.

6. Eight inactive accounts were identified.

We tell Morley that good federal funds should be deposited to cover federal funds wires. [illegible] continuing overdrafts are not appropriate in any of the Hutton accounts except possibly in zero balance accounts where the overdraft may equal the [illegible] clearings. If we do not have compensating balances in other Hutton accounts, we can book "as of" loans equal to the afternoon clearings. We also recommend that Morley review the list of eight inactive accounts and close those that are no longer needed.

The writer will be providing Morley with detailed analyses of their major accounts for the next couple of months as an aid to monitoring the activity in Hutton's accounts with us.



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RECEIVED

OCT 1 1981

STEPHEN A. LASERSON

To: Stephen A. Laserson, Vice President

From: Sharon R. Harris

Date 10-1-81

Tel. Ext.: 3975

Re: EF Hutton & Co., Inc. A/C 610-553593

I have investigated the 9/24/81 overdraft on this zero balance account. The amount of the overdraft was $49,491,872 although the afternoon clearings for that date amounted to only $2,448,217. The major portion of the overdraft was created by backdated debit items totaling $48,553,337. These items arose from incorrectly encoded checks which rejected from the system and therefore required manual posting to the account. This manual posting causes a one day delay between the date that checks are paid and the date that items are charged to the account.

This encoding problem was first discovered last May. Hutton was informed of the problem and agreed to order new checks. They estimated that they would need 2 to 2½ weeks to obtain these checks. At a later date, we discovered that no change has been made and we reporte the problem to the Treasurer, Tom Morley.

Since our meeting with Morley, Hutton has attempted to fund this account. On Sept. 21 and Sept. 22, for example, collected balances in the account were in excess of $100,000,000. However, this effort to fund the account has not been particularly successful and it is not an acceptable approach in light of the substantial credit exposur we take on certain days. According to Kevin Mahoney, Assistant Treasurer, this account will be closed no later than mid October, after n checks are ordered and a replacement account is set up at a one clear bank.

If we were to charge Hutton penalty interest on the uncollected bala in this account for June, July and August at the average call rate, the results would be as follows:

		Collected Balances	Average Call Rate	Fee
June	$	(5,005,000)	19.95%	$ 83,208
July		(9,622,000)	20.20%	167,369
August		(8,922,000)	20.20%	155,193
				$405,770

If we base the interest charge on the Fed Funds rate plus 10 basis points, the charge would be $376,455.

		Collected Balances	Average Fed Funds Rate + .10%	Fee
June	$	(5,005,000)	19.09% + .10% = 19.19%	$ 80,038
July		(9,622,000)	19.04% + .10% = 19.14%	158,587
August		(8,922,000)	17.84% + .10% = 17.94%	137,830
				$376,455

Mr. **Morley**. I don't particularly recall it, but there was a problem with a Bank of America check, and I don't remember if it was encoding or it was the heaviness of the embossment on the microencoding line.

But let me just make one comment, if you would, sir. The benefit Hutton received—there was no benefit to us. The bank would go back and charge our account all those items that they had not been able to do on an automatic basis; they would go back and charge us for that.

Now, on the Chemical, may I—do you want me to comment or tell you

Mr. **Feighan**. Please.

Mr. **Morley** [continuing]. Tell you briefly what I know about it? We are talking here about not misencoding or—there is a consecutive number on the bottom of the check, and that consecutive number is for the purpose, as far as I understand it, for account reconciliation, the bank account reconciliation function. They take those checks, and they sort those checks in consecutively numbered order, and they present them to our accounting department, and it makes them easier to do the account reconciliation.

The checks in question, I believe, were the branch reimbursement checks or the zero balance checks. The checks, the supply of checks, were exhausted. The cash desk ordered checks from the printer. The printer, it is my understanding, the printer pulled the wrong spec sheet, because when the account was first opened, the spec sheet that was given to the bank did not have the consecutively numbered order. So, when the order went in, the printer pulled the wrong spec sheet which did not have the consecutive number.

We ordered the checks. The checks were sent to the cash desk. Nobody checked to see if the specification was proper, they just took it as fact that the check would have the micro-encoding with the consecutive number.

Mr. **Feighan**. If I could just interrupt you, sir, you are establishing the fact, in fact, there was a problem with the Bank of America on encoding, as there was with Chemical Bank.

Mr. **Morley**. That is correct.

Mr. **Feighan**. That is correct.

As of September 30, 1981, Hutton had, in fact, written so many misencoded checks that the Chemical Bank ZBA account was overdrawn, because of that, in excess of $5.7 million.

You are aware of that problem at that point, Mr. Morley?

Mr. **Morley**. Repeat that, please, sir.

Because of the——

Mr. **Feighan**. Because of writing checks on the Chemical Bank ZBA account, there were caused to be overdrafts in excess of $47 million.

Mr. **Morley**. I can't verify that, sir. I can finish the story as far as the problem with the misencoding, if I may, or if you want to hear it.

The checks were supposed to have the proper consecutive number. They were sent out to the branch offices to be used in the normal course of events. At a later date—and I don't know how much, now, we're talking sometime in July—we thought the problem was solved. We thought we had ordered the checks.

We found out that it did not have the consecutive number on those checks. We reordered the checks with the specifications circled as far as to make sure the consecutive number would be on it. And I'm sorry to say the printer again printed them without the consecutive number.

Now it is embarrassing to us, you know; it looks terrible.

Mr. FEIGHAN. I don't know why you would say that, sir.

Mr. MORLEY. Again, we are trying to be as forthright and helpful——

Mr. FEIGHAN. I appreciate that.

Mr. MORLEY. It again came to my attention, Chemical said, you know, "I told you 6 months ago," or whatever the timeframe was——

Mr. FEIGHAN. Have you resolved the problems with the printer, as far as you know?

Mr. MORLEY. We finally resolved the problem.

Mr. FEIGHAN. Mr. Morley, would you consider it fraudulent to deliberately misencode checks in order to get an extra day or two's use of the money?

Mr. MORLEY. Yes, sir.

Mr. FEIGHAN. Mr. Fomon, would you concur in that assessment, that it would be fraudulent in order to deliberately misencode checks in order to get an extra day or two's use of the money?

Mr. FOMON. Yes. But we should also point out that we did not get an extra day.

Mr. FEIGHAN. Excuse me?

Mr. FOMON. As I understand the situation, we did not get an extra day because of the manual handling of these checks.

Mr. FEIGHAN. Well, with documentation from both Chemical Bank and the Bank of America to the contrary, that, in fact, they had to hire additional staff in order to handle the E.F. Hutton checks manually that were misencoded——

Mr. FOMON. It was my understanding that they charged us for that.

Mr. FEIGHAN. It was my understanding that in at least fairly recent months they have established that charge-back system. How extensive the charged-back system was for those additional costs for 1979 to 1984, I don't know. And perhaps at another point we can explore that.

Mr. MORLEY. I can add something: they did charge us back.

Mr. FEIGHAN. Mr. Fomon, you have repeatedly stated today and in writing that, at least to your knowledge, that the illegal or at least offensive procedures had stopped in 1982, once senior management became aware of them. But are you aware that in 1985 Hutton still has a major problem in miscoding checks?

Mr. FOMON. Misencoding checks?

No. I am not aware of that.

Mr. FEIGHAN. Just for the record, I might ask you, Mr. Fomon, was misencoding checks a deliberate policy at any time, to your understanding, a deliberate policy of E.F. Hutton?

Mr. FOMON. Well, I can't believe it. I have no way of knowing, but it is too stupid a thing to have been done willfully.

Mr. **Feighan**. You are stating, the , for the record, to your nowledge misencoding checks was not a deliberate policy of Iutton?

Mr. **Fomon**. Absolutely not.

Mr. **Feighan**. In May 1985, the Bank of America, in their internal memo, if I might quote for the record, stated that: "Hutton has dmitted to deliberately seeking to take advantage of check clearng delays. The prosecutor told me"—"me" being an individual at he Bank of America—"that this included deliberately tampering vith MICR"—that is the coding ink at the bottom of the check—on their checks, in order to obstruct presentation."

"These problems"—this is a memo dated May 7, 1985—"these roblems, that is the deliberate miscoding of checks, have recently ntensified. Hutton's checks are increasingly unreadable and must e manually recorded and manually interfiled."

Mr. **Fomon**. Who said that?

Mr. **Feighan**. Mr. Christopher T. Mahoney, vice president of Bank of America, a copy of which document I would be happy to rovide for you.

Mr. **Fomon**. Yes, I would like that very much.

Mr. **Hughes**. The document will be received without objection in he record. You will be provided with a copy.

[Information follows:]

NYCO/Financial Services #5111

Memo

To: John Swegle, VP/SH

Subject: Deposit Accounts of E.F. Hutton and Dean Witter

Date: May 7, 1985

Due to the Hutton case, we now have an opportunity to establish strict policies regarding the operation of E.F. Hutton's and Dean Witter's DDA accounts. Their cash management practices are under judicial and regulatory scrutiny, and they are on the defensive. We, along with the rest of the banks, have been pressing them on a number of issues without much success. I think that we are now in a position to dictate how we expect their accounts to be managed, especially in view of the fact that Hutton was convicted for certain practices which have been common in the industry.

Below are the main issues and my recommendations with respect to new policies:

1. Uncollected Balance Positions:

We currently analyze collected balances on a month-average basis, which has the unintended effected of allowing the depositor to borrow intra-month at his own option in any amount, and to repay by returning the principal for a like period. Wells Fargo and Crocker are on the verge of instituting the practice, with brokerage customers, of charging interest on daily uncollected positions at the posted broker rate and crediting positive collected balances at the Earnings Allowance Rate, thus earning a spread on the involuntary loans resulting from uncollected balances. This approach appears to be logical, since these are loans and do involve credit risk. I think we should adopt this policy, to be applied on a quarterly basis. For the time being, we will have to do this manually which will be time-consuming, but it strikes me as the best way to protect the bank, short of disallowing uncollected positions altogether, which is unrealistic. We won't be able to do this for Hutton until its accounts go on CDA, which will occur when they are migrated. Until that time, we should bill for average deficiencies on a monthly basis.

The Hutton injunction specifically prohibits Hutton from "causing uncollected funds in bank accounts to be withdrawn without the written consent of the banks." I would expect Hutton to ask us to consent to this and would agree to it on the basis of the foregoing arrangement.

2. Excessive Float:

This is a more intractable problem since it has so many causes, some of which are legitimate, such as concentration activity. There are three basic approaches we could take: (1) Prohibit certain float-causing practices, such as the deposit of large float items drawn on New York; (2) set a float limitation, such as a 1:1 ratio to collected balances; or (3) charge for float above a certain level (such as 100% of collected balances). I think that, of these options, the third is probably the best and most flexible. As to what we should charge, I would think that between 5 and 10 basis points per annum would be appropriate. Morgan is charging $150 per million on float in excess of $10 million as of statement date, which translates into 6 basis points per annum ($150 x 44 - $600). My inclination would be to charge 7.5 basis points per annum for float in excess of 100% of collected balances (or total float if collected balances are negative). This translates into $750 per million per year. This is a low amount, but it will incent the customers to reduce float.

3. Service Charges:

In order to clearly separate the issue of activity expense from the issue of collected balances, I think that we should bill service charges separately.

4. Check Quality: (Hutton only)

Hutton has admitted to deliberately seeking to take advantage of check-clearing delays. The prosecutor told me that this included deliberately tampering with the MICR on their checks in order to obstruct presentation. Account Rec. has had problems with Hutton's checks since the 1970's. These problems have recently intensified; Hutton's checks are increasingly unreadable and must be manually re-MICRed and manually interfiled. This has now been picked up by NAD Audit Division in its audit of the Brea Account Rec. Center. Although we are billing Hutton for these costs, the solution is better checks. We have conveyed to them in detail what is wrong with their checks (on 4/25) but so far nothing has been done. Therefore, I think that the time has come for us to require that Hutton select a vendor acceptable to us; that the specs be acceptable to us; and that random samples of each batch be submitted to us for testing. This parallels Audit's recommendations. (We will also bill Hutton for past processing costs caused by poor quality checks.)

5. Clearinghouse Loans: (Dean Witter)

Dean Witter is the only customer to whom we still lend on a clearinghouse basis. This system creates float at disbursement and repayment; is troublesome in that we have to keep track of Friday paydowns and borrowings because of the three-day clearing delay. Ultimately the auditors are going to pick this up and require us to terminate the practice since it creates float and potentially exposes the bank to float due to the repayment by check. In view of these problems, I think we should terminate this arrangement and offer only Fed Funds loans to Witter. This will cause them some problems and may reduce their borrowings from us, but I am convinced that we will be better off in the long run if we eliminate this unorthodox arrangement. Furthermore, if we are ever going to do this, now is the best time, in the wake of the Hutton scandal. (With respect to Friday paydowns/borrowings, I think we should calculate the interest on their net position and bill them.)

6. Account Migration: (Hutton)

We should proceed to migrate Hutton's accounts into #1235 without further delay.

Christopher T. Mahoney, VP

CTM/ag

Mr. **Feighan**. In light of that memorandum, Mr. Fomon, do you have a comment on the policy that E.F. Hutton has in terms of coding or misencoding of checks and what problems might still exist?

Mr. **Lynch**. I might comment on that.

Mr. Morley and I met with Mr. Mahoney——

Mr. **Feighan**. In May?

Mr. **Morley**. I believe so.

Mr. **Lynch**. And he told us at that time that there was still a problem with the printing and the quality of the checks that were being provided. He made no indication that this was being done deliberately, and we assured him that we would go back to the printer and try to get the quality improved. But I have met with——

Mr. **Feighan**. Excuse me, Mr. Lynch, if I might just respectfully interrupt.

I'm not concerned at this point, any more, with the problems that you've had with your printer. I am talking about what is alleged to be deliberate miscoding of checks in order to delay the process.

Mr. **Fomon**. Who does that gentleman say, whom does he quote as saying that we were deliberately misencoding?

Mr. **Feighan**. He stated—Mr. Christopher Mahoney states in his May 7 memo of this year: "Hutton has admitted to deliberately seeking to take advantage of check clearing delays. The prosecutor told me that this included deliberately tampering with the MICR"—that means the coding at the bottom of the check—"on their checks, in order to obstruct presentation."

Mr. **Fomon**. Well, I frankly think that is a bad rap. I know who told that gentleman that, and I don't think there is any evidence. There may be, but I don't think there is any evidence of willfully tampering with the coding on checks.

Mr. **Feighan**. It certainly must concern you that one of your major banking customers has that idea of your practices.

Mr. **Fomon**. Had we been tampering with coding on checks I would think we would have been charged with that.

Mr. **Feighan**. That is the point of these hearings.

Mr. **Fomon**. No, but by the Justice Department. That seems to me a rather serious charge.

Mr. **Hughes**. The gentleman's time is up.

The gentleman from Kentucky.

Mr. **Mazzoli**. I thank the chairman, and I will just follow up for a second on what my friend from Ohio has gone into here.

Can you give me just—or maybe Mr. Castellano—just about how much, roughly, would a printing bill from this bank printer be for Hutton for 1 month or 1 year? Any idea how much loot that guy is carrying away, that printer that can't get it right?

Mr. **Castellano**. I have no idea.

Mr. **Mazzoli**. $1 million a year, do you think, the printing bill?

Mr. **Castellano**. I have absolutely no idea.

Mr. **Mazzoli**. $2 million? $3?

Mr. **Fomon**. I would doubt if it's a big amount, because I would think that check printing is a specialty, and a typical check printer would not be getting regular printing business from E.F. Hutton.

Mr. **Mazzoli.** Well, it seems to me—and I listened to what the gentleman said, and I'm sure he said it from his heart but it just wasn't very convincing to me—that you've got to get two, and three, and four runs of checks before they get the consecutive numbers right. I mean, to me, you'd have a case in court against a bank printer for being incompetent, materially involved in a swindle, or fraud. I can't believe you just simply bring the checks back and say, "Hey, Mister, we love you; would you print it right?"

Mr. **Fomon.** I'd be glad to get you the numbers on how much business we do with this printer.

Mr. **Mazzoli.** I would love it.

[Information follows:]

Inter-Office Memorandum EF Hutton

TO Tom Morley

FROM Paul Hines

SUBJECT Testing of Checks

DATE June 20, 1985

Effective immediately, I want you to insure that all reorders or new orders of E.F. Hutton & Company Inc. checks be given to the bank prior to use for testing by the Purchasing Department and we must receive from the bank positive confirmation that it passed the test before issuing to the branches.

cc: M. Castellano
T. Lillis
J. Moorhead
M. Catalano

Paul Hines

FC 14A (Rev. 11/80)

Bank of America

Christopher T. Mahoney
Vice President

North America Division
New York Office

May 31, 1985

Mr. Thomas P. Lynch
President
E.F. Hutton Group, Inc.
One Battery Park Plaza
New York, NY 10004

Dear Tom:

At our meeting On May 9th, Bruce Mitchell outlined a number of changes in our bank's approach to depository services which we are implementing at this time. Bruce indicated that we would be following up with details on these changes, which are provided below.

At the outset, I would like to reiterate Bruce's assurance that we value our operating relationship with E.F. Hutton and our objective is to continue to provide you with excellent depository services at a fair price. We believe that the changes described below are both fair and logical.

1. Collected Balance Positions

We will no longer analyze collected balances on a month-average basis. Instead, we will accrue interest on daily uncollected positions at our average monthly posted broker rate, and will credit interest on collected positions at our earnings allowance rate. These will be netted and the amount due the bank (if any) will be payable monthly. Positive accruals will not be carried. This policy will be effective beginning June 1, 1985.

For the period January-April of this year, we have compiled the attached calculation of your balance positions on a month-average basis, which indicates a deficiency over this period (Attachment I). We have billed this at our average monthly posted broker rate. We will do the same for May when we receive the account analysis.

Bank of America National Trust and Savings Association 335 Madison Avenue New York NY 10017

2. Float

Although float is a by-product of certain depository activities, it is also expensive for us, since it is a sterile use of our balance sheet and thus incurs a capital usage cost. There should be a relationship between depository activity and the resulting float; we view float above this amount as excessive and we will charge back the cost of this float to the customer. In the case of E.F. Hutton, we have set $10 million as the level above which we will charge for float. For the time being, this charge will be assessed on a month average basis at .10% p.a., although this charge may be adjusted upwards in the future since the bank has not yet rendered a final decision on this issue. This policy will also be effective beginning June 1, 1985.

Although we will be charging for float, the above price of .10% does not fully recover the full opportunity cost to us of float, which is higher. Therefore, we also request that you terminate unnecessary float-creating practices, such as funding your accounts with large items drawn on your New York accounts, and other such float-creating activity which does not represent the concentration of customer funds.

3. Direct Debit

Effective immediately, we will collect all loan and depository fees and interest via direct debit, with itemized prenotification by mail.

4. Check Quality Issues

The quality of your checks has been a recurring problem since the 1970's. These problems have caused costly processing difficulties at our check clearing and deposit reconcilement departments due to the very high level of rejected items and the resulting reconcilement problems, both due to the unreadability of your items. These problems have been brought to your attention a number of times in the past. We are still in the process of compiling a bill for the incremental expense incurred by our Data Processing and Account Reconcilement departments since 1982 due to the manual tasks resulting from the unusually high level of non-reads. Also, as I indicated to Tom Morley, we will no longer be able to credit your account for non-reads pending research.

The solution to these problems is a speedy improvement in check quality. We would like to see these problems (as measured by our reject rate) resolved by August 31, 1985. By that time, we would expect you to be using checks which meet our specifications and which have a reject rate of not more than .5% on the first passes on the reader/sorter during clearing, and a reject rate of not more than 4% during sequencing for reconcilement. Our check people have been in contact with your vendor since our meeting, and have made some progress. (See Attachment II.) We would also like to receive samples of your new checks for testing, and we would also like to receive samples of subsequent batches as they are produced. In this way, we will save each other considerable trouble and unnecessary expense.

5. Account Migration

We would like to proceed to replace your 37-odd branch accounts with a single concentration account into which all Hutton locations will deposit. This account will be on deposit reconcilement with monthly cumulative reports. We will provide your branches with deposit tickets with their addresses and accounting numbers printed in the upper left-hand corner, which will also be MICR-encoded by location in order to have their daily (ledger) deposit data picked up on Bamtrac detail reporting. A separate account will be set up for returned items which will ZBA from the concentration account. We will be able to provide your Los Angeles office with photocopies of returned items daily by rapifax, which will show the branch location on the endorsement stamp. The checks themselves will be sent to your L.A. office by mail.

We are ready to proceed with this immediately. We believe that this new configuration will be cheaper for you, and will also result in better service, since all of your depository activity will be at the Corporate Service Center. We are committed to managing this transition smoothly, and with as little disruption to your operations as possible.

Later this year, we plan to consolidate our Corporate Service Centers in San Francisco (North) and Covina (South) into one centralized unit located in Concord (near San Francisco). This change should be transparent to you; your account numbers will not change. For this reason, we wish to move your branch accounts to our Northern Service Center now, in order anticipate this consolidation. These accounts will remain under the control of the Hutton account administrator in Covina, pending the consolidation which will occur later in the year.

Tom, I hope that these changes as outlined above will work to our mutual benefit. Our bank remains committed to providing superior services to major depository customers such as E.F. Hutton.

Sincerely,

Christopher T. Mahoney

CTM/sg
Atts.

cc: Tom Morley, SVP
E.F. Hutton & Co.

ATTACHMENT I

E.F. Hutton 1985 Account Balances

	Ledger	Float	Collected	(+) EAR	(-) Interest
January	66,067,646	64,900,040	1,167,605	8,072.15*	
February	48,293,877	60,826,594	(12,532,717)		92,602.85
March	56,586,022	65,351,874	(8,765,853)		72,313.42
April	62,829,676	48,154,437	14,675,239	89,691.84*	
				97,763.99	164,916.27

Total Amount Due: $67,152.28

EAR (Earnings Allowance Rate) is based on the average daily bond equivalent yield of 90-day treasury bills for the preceding 3 mos. rounded up 1/4%.

1/85 - 9.25%
4/85 - 8.45%

Interest - Broker's Prime Weighted Average

2/85 - 9.5 %
3/85 - 9.58%

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* Figures adjusted for reserves

Bank of America
P. O. Box 37000
San Francisco, CA 94137

May 22, 1985

Mr. Joseph Di Donato
Northeast Forms, Inc.
47 West Street
New York, NY 10006

Dear Mr. Di Donato:

On April 25, 1985, I spoke with you regarding the problems with E.F. Hutton's checks drawn on account numbers 12358-00088 and 12351-00213.

As I stated, the problems are as follows:

1. Large voids and spotting within the characters.
2. Ink on the checks is lifting off.
3. On-Us symbol has a halo around the right symbol only.
4. Sequential numbering on occasion is printed crooked.

In addition, the following questions were asked. And you stated that you would let me know what steps are being taken to improve your quality.

1. What quality control measures are being taken prior to each run, such as equipment or gages?
2. What type of equipment are they printed on and how often is the equipment maintained or adjusted? Daily, weekly?
3. What type of ribbon is purchased?
4. Do you test each shipment of ribbons prior to use?
5. Where are the ribbons stored? Excessive hot or cold areas?
6. Are the checks printed on 60lb offset or 24lb MICR bond?
7. Which way is the grain going?

Joe, should you need additional information regarding gages or MICR manuals, please give me a call at (415) 622-7166.

Bank of America National Trust and Savings Association

Bank of America
P. O. Box 37000
San Francisco, CA 94137

Page #2

Enclosed is my business card.

Sincerely,

Karen de Klerk
Assistant Vice President
Customer CHeck Support
Services #3075
(415) 622-7166

cc: T. Sherman
T. Morley
J. Still

encl.

Bank of America
P. O. Box 37000
San Francisco, CA 94137

June 07, 1985

Mr. Thomas Sherman
E. F. Hutton
1 Broadway Way
New York, NY 10004

Dear Tom:

Enclosed is a copy of the letter to Northeast Forms, Inc., stating that their samples are exceptable. However, I would like to establish a procedure through you to continue to receive samples on a regular basis.

Please let me know what arrangements would be best for you.

Sincerely,

Karen de Klerk
Assistant Vice President
Customer Check Support
Services #3075
(415) 622-7166

Enclosure.

Bank of America National Trust and Savings Association

Bank of America
P. O. Box 37000
San Francisco, CA 94137

June 07, 1985

Mr. Joseph Di Donato
Northeast Forms, Inc.
47 West Street
New York, NY 10006

Dear Mr. Di Donato:

Per our conversation, enclosed is the results for account numbers 12358-00088 and 12351-00213.

In both cases they are exceptable. However, in the future we would like to receive samples periodically to ensure the best possible quality.

Thank you for the samples and we look forward to receving additional ones in the future.

Sincerely.

Karen de Klerk
Assistant Vice President
Customer CHeck Support
Services #3075
(415) 622-7166

cc: T. Sherman
J. Still

Enclosure.

Magnetic Ink Encoding Evaluation

BRANCH/PRINTER EF HUTTON

WORK OF 06-04-85 STYLE A/C 12351-00213

EVALUATED BY Rustom Swaleh

CONCURRENCE Marie Grant

CUSTOMER CHECK SUPPORT SERVICES #3075

BATCH NO. 5337

DATE 06-06-85 19

ITEMS RECEIVED 1000, (*Visually. 200 at random)

ITEMS EVALUATED 1000, (*Visually. 200 at random)

COMPUTER REJECTS None

ITEMS OF NON-COMPLIANCE 13

xx☒ ACCEPTED ☐ REJECTED

A numeric sampling of the above checks has been evaluated to determine compliance with the American Bankers Association Specifications, (147 R 3, THE COMMON MACHINE LANGUAGE FOR MECHANIZED CHECK HANDLING AND THE SUPPLEMENT TO 147 R 3).

The number of recurring casualties on the non-compliance items are listed below. The remarks column indicates any areas of trouble, whatsoever, and is reported both in the case of unacceptable and marginal work.

This report refers only to the batch of checks described above and does not constitute an endorsement by the Bank of America of this printing concern and its ability to print magnetically encoded checks.

SPECIFICATIONS		*RECURRENCE OF NON-COMPLIANCE	REMARKS
PAPER WEIGHT	24lb. MICR BOND or EQUIVILANT		
FORMAT (CODING LOCATION)	± 1 16 INCHES		
SPACING	.125 – .010 INCHES		
CHARACTER SKEW	± 1½ DEGREES		
ALIGNMENT OF ADJACENT CHAR.	.007 INCHES		
EMBOSSMENT	.001 INCHES		
SIGNAL LEVEL	50 – 200%		
CHARACTER DIMENSIONS	± .0015 IN. FROM NOMINAL EDGE (MIN. HORIZ. BARS .011 IN.)		
UNIFORM INK	AVERAGE EDGE EDGE SQUEEZE OUT NO MORE THAN .0015 IN.		
CHARACTER EDGE IRREGULARITY	25% OF EDGE UP TO .002 IN. BEYOND AV. TOLERANCE		
VOIDS	.008 IN. x .008 IN. ANYWHERE IN CHAR. ZONE .010 x .010 IN. WITHIN MULTIPLES SEGMENTS LONG THIN VOIDS .002 WIDE TOTAL VOIDS IN COLUMN OR ROW 30%	* 11	(5) Broken character in all three fields. (3) Broken symbol in all three fiel (3) Insufficent ink in Transit Rou-ing & ON-US field.
EXTRANEOUS INK – FRONT	ONE .004 x .004 SPOTS PER CHAR. ZONE BUT MAX. OF 5 PER FIELD	* 2	Ink smear in AUX-ON-US & TRANSIT-ROUTING fields.
EXTRANEOUS INK – BACK	UP TO .006 x .006 OR EQUIVALENT SPOTS		

NOTE: PLEASE VOID ALL CHECKS BEFORE FORWARDING FOR EVALUATION.

3075-10

Magnetic Ink Encoding Evaluation

BRANCH/PRINTER EF HUTTON

WORK OF 05-22-85 STYLE A/C 12358-00088

EVALUATED BY Rustom Swaleh

CONCURRENCE Marie Grant

BATCH NO. 8558

DATE 06-11-85 19

ITEMS RECEIVED 230 Visually 60 at random

ITEMS EVALUATED 230 Visually 60 at random

COMPUTER REJECTS None

ITEMS OF NON-COMPLIANCE 1

CUSTOMER CHECK SUPPORT SERVICES #3075

☒ ACCEPTED ☐ REJECTED

A numeric sampling of the above checks has been evaluated to determine compliance with the American Bankers Association Specifications. (147 R 3, THE COMMON MACHINE LANGUAGE FOR MECHANIZED CHECK HANDLING AND THE SUPPLEMENT TO 147 R 3).

The number of recurring casualties on the non-compliance items are listed below. The remarks column indicates any areas of trouble, whatsoever, and is reported both in the case of unacceptable and marginal work.

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SPECIFICATIONS		*RECURRENCE OF NON-COMPLIANCE	REMARKS
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FORMAT (CODING LOCATION)	± 1 16 INCHES		
SPACING	.125 – .010 INCHES		
CHARACTER SKEW	± 1½ DEGREES		
ALIGNMENT OF ADJACENT CHAR.	.007 INCHES		
EMBOSSMENT	.001 INCHES		
SIGNAL LEVEL	50 – 200%		
CHARACTER DIMENSIONS	± .0015 IN. FROM NOMINAL EDGE (MIN. HORIZ. BARS .011 IN.)		
UNIFORM INK	AVERAGE EDGE EDGE SQUEEZE OUT NO MORE THAN .0015 IN.		
CHARACTER EDGE IRREGULARITY	25% OF EDGE UP TO .002 IN. BEYOND AV. TOLERANCE		
VOIDS	.008 IN. x .008 IN. ANYWHERE IN CHAR. ZONE .010 x .010 IN. WITHIN MULTIPLES SEGMENTS LONG THIN VOIDS .002 WIDE TOTAL VOIDS IN COLUMN OR ROW 20%	1	Broken character in ON-US-field.
EXTRANEOUS INK – FRONT	ONE .004 x .004 SPOTS PER CHAR. ZONE BUT MAX. OF 5 PER FIELD.		
EXTRANEOUS INK – BACK	UP TO .006 x .006 OR EQUIVALENT SPOTS		

NOTE: PLEASE VOID ALL CHECKS BEFORE FORWARDING FOR EVALUATION.

3075-18

EF Hutton
INTER-OFFICE MEMORANDUM

TO Mike Catalano
FROM Thomas P. Morley
DATE May 16, 1985
SUBJECT BOA Check Quality

As you may be aware, Bank of America has been advising us of an ongoing problem concerning quality control problems with our BOA checks printed by NorthEast Business Forms.

On April 25, Tom Sherman, Hugh van Hengel and myself met with two Bank of America loan officers, at which point a conference call with Karen DeKlerk, of BOA's Customer Check Support group, was made. According to Ms. De Klerk, basically because of various quality problems with the MICR line of our checks, we have a check reject rate far in excess of industry standards. Because of this high reject rate, our account has required special handling by BOA, equating to approximately $950.00 a month in added labor costs. Tom Sherman then briefly discussed the problem with NorthEast Business Forms and asked them to expect a call from Ms. DeKlerk to try working with them in resolving the problem.

Subsequently, last week this situation was again discussed at a meeting with BOA, Tom Lynch and myself. Apparently, this problem has yet to be resolved, and BOA can not understand why our level of rejects can not be reduced to the industry standard. I am at a loss to explain it as well, and at this point it is damaging our overall relationship.

I would appreciate it if at this point, you could look into the problem and shepherd it to a satisfactory resolution. We face both permanent damage to our relationship, as well as the $950.00 per month special handling charge.

If I can be of any assistance in this process feel free to contact me. Though let me stress that we should move as rapidly as possible in solving this problem, even if it means changing our current printer.

Please keep me informed.

Tom

cc: Hugh van Hengel
Thomas Sherman

MEMORANDUM June 20, 1984

Re: "Misencoded" Checks

Prior to late 1981 Hutton maintained its principal branch reimbursement account at Chemical Bank. Checks for this account were preprinted "Pay to the order of E. F. Hutton & Company Inc." and sent to all the branches for use in avoiding negative bank ledger balances. A Hutton branch would deposit a Chemical check in its branch bank to reimburse itself, the check would clear through the banking system and be presented to Chemical, and the Company would fund payment of each day's clearings by wire transfer. The Company ordered several thousand of these checks from the printer at a time, divided them into small batches, and sent them out to branches as needed.

The Company's chief check printer is Northeast Forms, Inc. Northeast prints stock checks for the Company in batches of 100,000 and holds them until the Company orders smaller batches (usually between 1,000 and 10,000) for its branches. To order checks the Company's purchasing department sends the printer a "Z-Release" form, which authorizes him to release a certain number of checks from stock (Exhibit 1). This release specifies the form number of the checks being ordered, the address to be printed on the checks, and the check numbers to be printed in Arabic numerals on the upper right of the check. If special instructions accompany the order, the statement "See attached specification sheet" will appear on the Z-release. The specification sheets include a "Specifications for Printing Checks" form, which sets forth the bank name and address, the transit and routing code, and the microencoding instructions (Exhibit 2). This is attached to a "Specifications for Printing Forms" sheet that designates the form number of the checks, the quantity, the check numbers, and the priority of the order (Exhibit 3).

The coding that was missing from some checks should have appeared at the bottom of each check on the "MICR" (magnetic ink character recognition) or microencoded line. The MICR line of all of Hutton's checks contained the account number and a routing code for clearing. What was missing from some batches of checks was the sequential check number (i.e., check numbers 1, 2, 3, etc.) on the MICR line, although the sequential check numbers were printed in Arabic numerals in the upper right-hand corner of all checks.*

It is perhaps misleading to describe the checks at issue as "misencoded", since they were properly (albeit incompletely) encoded. The sole function of placing check numbers on the MICR line was to enable the bank to provide a monthly statement to the Company listing the checks that had cleared in numerical order. This service, called "Account Reconciliation Process" or "ARP", requires that a sorting machine read the MICR line.

---

* See Exhibit 4 for an example of a check with a microencoded sequence number. Note that "06933" appears at the extreme left of the MICR line.

Apparently, when checks without microencoded sequence numbers were presented to Chemical, they were rejected by the ARP system and had to be manually debited from the account, resulting in a one-day delay in debiting. Hutton would therefore be credited with an extra day's collected balances in the amount of the late-posted checks, even though Chemical had already paid the checks to the presenting bank. That this occurred at all is somewhat puzzling, since one would not think that the lack of a microencoded sequence number on a check would prevent the bank's computer from immediately debiting the proper account. The account numbers were correctly microencoded, and account debiting is obviously a more pressing concern to the bank than providing a customer with an account reconciliation. The Company believes, therefore, that this matter was primarily an operations problem at Chemical.

In any event, the lack of complete microencoding on the checks for this account was not willful, albeit it did drag on through a series of errors. When the account was opened in

1979, Hutton ordered 5,000 checks (numbered 1 to 5000) from its printer (Exhibit 5). The October 5, 1979 specification sheet (Exhibit 2) did not originally specify consecutive coding.

The Specification for Printing Forms sheet, which was sent to the printer along with Z Release # 14349 (Exhibit 6), requested that the printer send 50 samples to Hutton to be forwarded to Chemical for testing. The Company believes this was not done.

It is not clear precisely when Chemical requested the consecutive coding for this account, but on February 7, 1980 the October 5, 1979 specification sheet was revised and "X000000X" was written in heavy marker in the "Consecutive Number" box. This sheet also reads, in heavy marker, "Per Chem Bank -- MICR Consec # Required, Revised 2/7/80" (Exhibit 2). Since this order was for checks numbered 2,000 to 7,000, checks numbered 2,000 to 5,000 from the first batch were probably never used. This specification sheet was sent to the printer along with Z Release # 16102 and a Specifications for Printing Forms sheet that requested "MICR Consecutive Numbering" (Exhibit 7). The second order arrived fully microencoded, and the checks were distributed to the branches as necessary.

Eventually the supply of checks ran low, and another order was placed on April 12, 1981. The Z Release order

22751 (Exhibit 8) did not have a specification sheet attached and does not on its face refer to such an attachment, probably because this was merely a reorder that did not require any new specifications to be sent. MICR information does not appear on the Z-Release, so it would quite literally have been impossible for the printer to print the checks without referring to the prior specification sheet -- otherwise the entire microencoded line would be missing. The printer, in referring to that prior specification form, apparently overlooked the consecutive number coding requirement, because the MICR sequence coding on this batch of checks (numbered 7,001 to 13,000) was omitted. As this third order required the printer to reproduce checks with the same specifications as the second order, and as the second order had properly included microencoded consecutive numbering instructions (which, indeed, had been followed), it seems clear that the party responsible for the coding failure was the printer.

When Chemical told Hutton in June 1981 that uncoded checks were hitting the account, a new check order was placed, now for checks numbered 13,001 to 18,000. The Company again specified that consecutive numbering was to appear on the MICR line, and it also sent the bank's specification sheet to the printer to indicate where the numbers were to be placed (Exhibit 9). When these checks were delivered to the Company, however, the clerk who signed for them did not check them against the specification, and they were sent to the branches as received. No one noticed that the printer had not only omitted consecutive numbering on the MICR line but had also failed to print "E. F. Hutton & Company Inc." on the checks as he was supposed to do.

While any effect of this lack of consecutive microencoding should have been immediately apparent to Chemical, the Company had little notice of it because the account was not included on the monthly account analyses until late summer or early fall of 1981. Thus, apart from one telephone call in June -- which raised a problem the Company thought it solved by reordering checks -- the Company was not aware of the continued existence (much less the extent) of the check coding problem until late August, at which time Chemical backcharged the account to correct the erroneously computed balances.

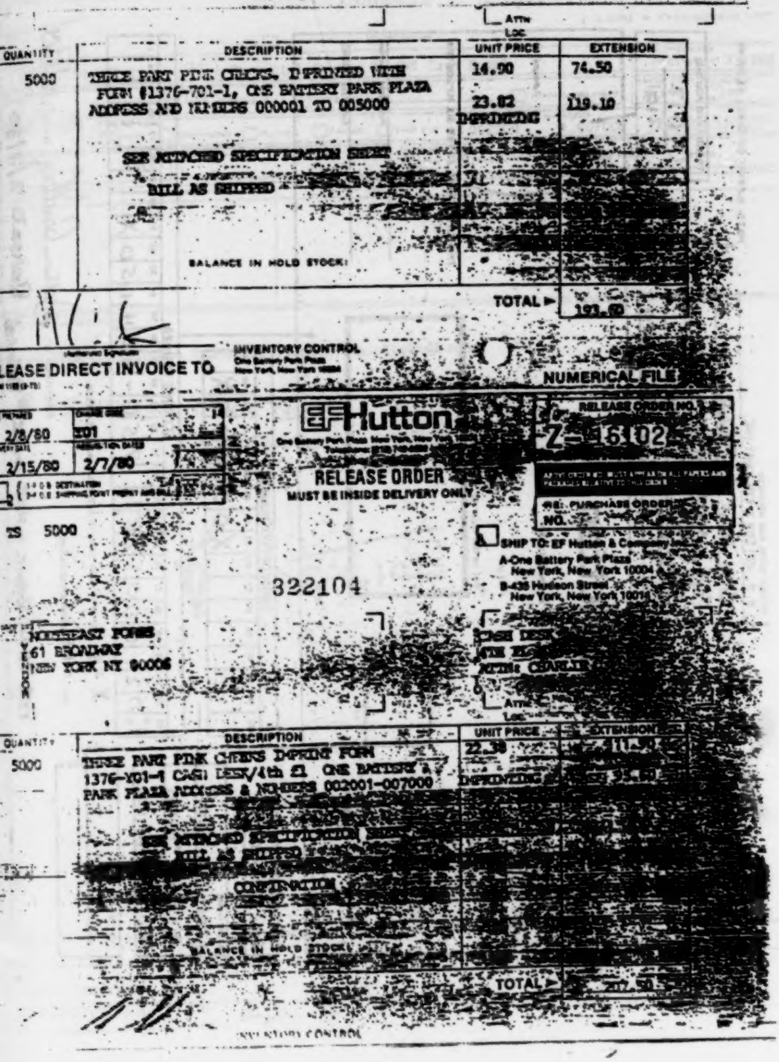
Shortly thereafter the Company determined to close the account for unrelated operational reasons. The matter of uncoded checks was therefore regarded as solved, and the possibility of yet another reorder of checks was not considered. It took longer than anticipated, however, to effect the transfer of the branch reimbursement functions from Chemical to United States Trust Co., and non-sequentially-coded checks continued to hit the account for some time. Chemical was aware of this and charged the Company for use of funds as appropriate. The Company could not and did not gain at the expense of the bank.

Indeed, at any time during this series of mishaps (which might in other circumstances be considered humorous), Chemical had several alternatives it could have pursued: the bank could have refused to reconcile the account and returned the checks in bulk, making a lump sum debit to the account; it could have had new checks printed and insisted that the Company distribute them; it could even have invoked the banker's time-honored devices for catching his customer's attention -- bouncing checks or closing the account. Chemical did none of these things, and the reason why is obvious: the matter was being handled in the ordinary course, and no stern measures were called for.

Notwithstanding what the prosecutor may or may not have told a Bank of America official, no willful conduct was involved. This was a non-event.

E. F. Hutton & Company Inc.

EXHIBIT 1



ATTN
LOC

QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
5000	THREE PART PINK CHECKS, IMPRINTED WITH FORM #1376-701-1, ONE BATTERY PARK PLAZA ADDRESS AND NUMBERS 000001 TO 005000	14.90	74.50
		23.82 IMPRINTING	119.10
	SEE ATTACHED SPECIFICATION SHEET BILL AS SHIPPED		
	BALANCE IN HOLD STOCK:		
		TOTAL ►	193.60

(Authorized Signature)

LEASE DIRECT INVOICE TO

INVENTORY CONTROL
One Battery Park Plaza
New York, New York 10004

NUMERICAL FILE

EF Hutton
One Battery Park Plaza New York, New York

RELEASE ORDER
MUST BE INSIDE DELIVERY ONLY

RELEASE ORDER NO.
Z-16102

ABOVE ORDER NO. MUST APPEAR ON ALL PAPERS AND PACKAGES RELATIVE TO THIS ORDER

RE: PURCHASE ORDER NO.

2/8/80	201
2/15/80	2/7/80

1-F.O.B. DESTINATION
2-F.O.B. SHIPPING POINT PREPAY AND BILL

TS 5000

322104

NORTHEAST FORMS
61 BROADWAY
NEW YORK NY 90006

☐ SHIP TO: EF Hutton & Company Inc.
A-One Battery Park Plaza
New York, New York 10004
B-435 Hudson Street
New York, New York 10014

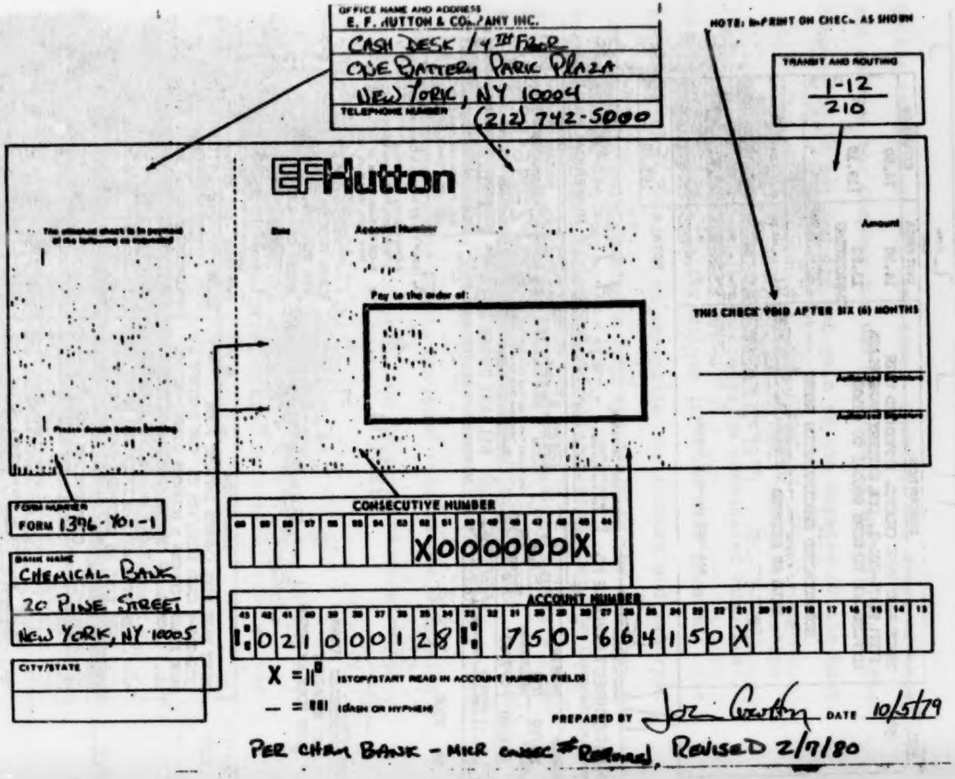
CASH DESK
4TH FL[illegible]
ATTN: CHARLIE

ATTN
LOC

QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
5000	THREE PART PINK CHECKS IMPRINT FORM 1376-Y01-1 CASH DESK/4th FL ONE BATTERY & PARK PLAZA ADDRESS & NUMBERS 002001-007000	22.38	111.[illegible]
		IMPRINTING	95.60
	SEE ATTACHED SPECIFICATION SHEET BILL AS SHIPPED		
	CONFIRMATION		
	BALANCE IN HOLD STOCK:		
		TOTAL ►	207.50

INVENTORY CONTROL

EXHIBIT 2



OFFICE NAME AND ADDRESS
E. F. HUTTON & COMPANY INC.
CASH DESK / 4TH FLOOR
ONE BATTERY PARK PLAZA
NEW YORK, NY 10004
TELEPHONE NUMBER (212) 742-5000

NOTE: IMPRINT ON CHECK AS SHOWN

TRANSIT AND ROUTING $\frac{1-12}{210}$

EFHutton

The attached check is in payment of the following as requested

Please detach before banking

Date

Account Number

Pay to the order of:

Amount

THIS CHECK VOID AFTER SIX (6) MONTHS

Authorized Signature

Authorized Signature

FORM NUMBER
FORM 1396-Y01-1

BANK NAME
CHEMICAL BANK
20 PINE STREET
NEW YORK, NY 10005

CITY/STATE

CONSECUTIVE NUMBER

60	59	58	57	56	55	54	53	52	51	50	49	48	47	46	45	44
								X	0	0	0	0	0	0	X	

ACCOUNT NUMBER

43	42	41	40	39	38	37	36	35	34	33	32	31	30	29	28	27	26	25	24	23	22	21	20	19	18	17	16	15	14	13
⑆	0	2	1	0	0	0	1	2	8	⑆		7	5	0	-	6	6	4	1	5	0	X								

X = ⑈ (STOP/START READ IN ACCOUNT NUMBER FIELD)

— = ⑉ (DASH OR HYPHEN)

PREPARED BY DATE 10/5/79

PER CHEM BANK - MICR CHECK # REMOVED, REVISED 2/7/80

EXHIBIT 3

SYSTEMS & PROCEDURES DEP

☐ NEW FORM ☒ REVISION

FORM NUMBER: Form 1376-Y01-1

FORM TITLE: 3 Part Pink Chuck ▮ (NY Cash Desk)

DATE PREPARED: February 7,1980

QUANTITY: 5,000

PRIORITY: ☒ RUSH NEED ASAP ☐ NEED BY ________ ☐ NORMAL DELIVERY

ROUGH COPY ATTACHED: ☒ YES ☐ NO

NUMBER OF PARTS: 3

TYPE OF FORM: ☒ CHECK ☐ CONTINUOUS ☐ PLATBED ☐ PADDED ☐ SNAP OUT

CONSECUTIVELY NUMBERED: 002000 TO 007000

☒ M.I.C.R. SPECIFICA SHEET ATTACHED

PUNCHING: " DIAMETER "C TO C

OVER ALL SIZE:

HOW PREPARED: ☐ PEN ☒ TYPEWRITER ☐ HIGH SPEED PRINTER ☐ OTHER

PART	WEIGHT	COLOR OF PAPER	COLOR OF INK	MARGINAL WORDING

ADDITIONAL INFORMATION

Add MICR Consectuive Numbering as shown on attached spec.

SHIP TO: CASH DESC
4th Floor
ATTN C. Anzalone

Z-16102

209384

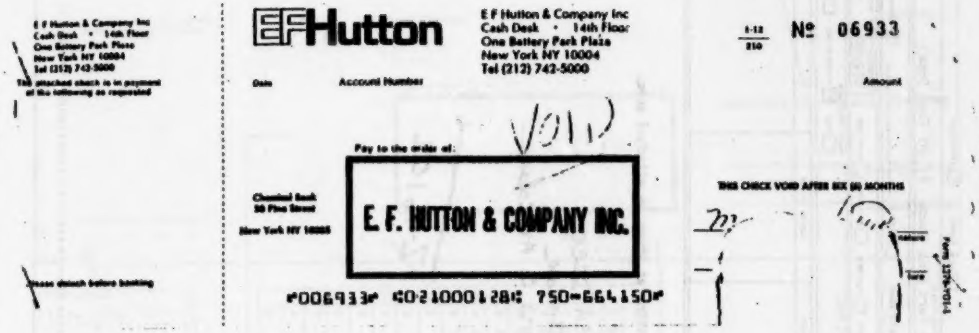
NOTE: SEND 10 COPIES OF THE PRINTED FORM TO SYSTEMS & PROCEDURES - FAILURE TO DO SO WILL BE A CONSIDERATION WHEN REORDERING THE FORMS

PROOFS REQUESTED ☐

PROOFS RECEIVED (DATE) | OK | OK WITH CORRECTIONS | NEW PROOF | INITIALS

APPROVED BY

EXHIBIT 4



E F Hutton & Company Inc
Cash Desk • 14th Floor
One Battery Park Plaza
New York NY 10004
Tel (212) 742-5000

The attached check is in payment of the following as requested

Please detach before banking

EF Hutton

E F Hutton & Company Inc
Cash Desk • 14th Floor
One Battery Park Plaza
New York NY 10004
Tel (212) 742-5000

1-12/210 № 06933

Date

Account Number

Amount

Pay to the order of:

VOID

E. F. HUTTON & COMPANY INC.

Chemical Bank
20 Pine Street
New York NY 10005

THIS CHECK VOID AFTER SIX (6) MONTHS

Signature

Signature

Form 1270-Y01-4

⑈006933⑈ ⑆021000128⑆ 750-664150⑈

EXHIBIT 5

EFHutton
INTER-OFFICE MEMORANDUM

TO John Cowhey
FROM William Sullivan
DATE October 4, 1979
SUBJECT Branch Disbursement Account for Chemical Bank

I would appreciate your ordering 5,000 checks for our new account with Chemical Bank.

I have attached the specification sheet for our account, and would appreciate your advising me when the checks are ready so that I may send 50 such checks for "testing" at Chemical Bank.

Thank you,

Bill

1376 Y01-1

FC 144 (REV. [illegible])

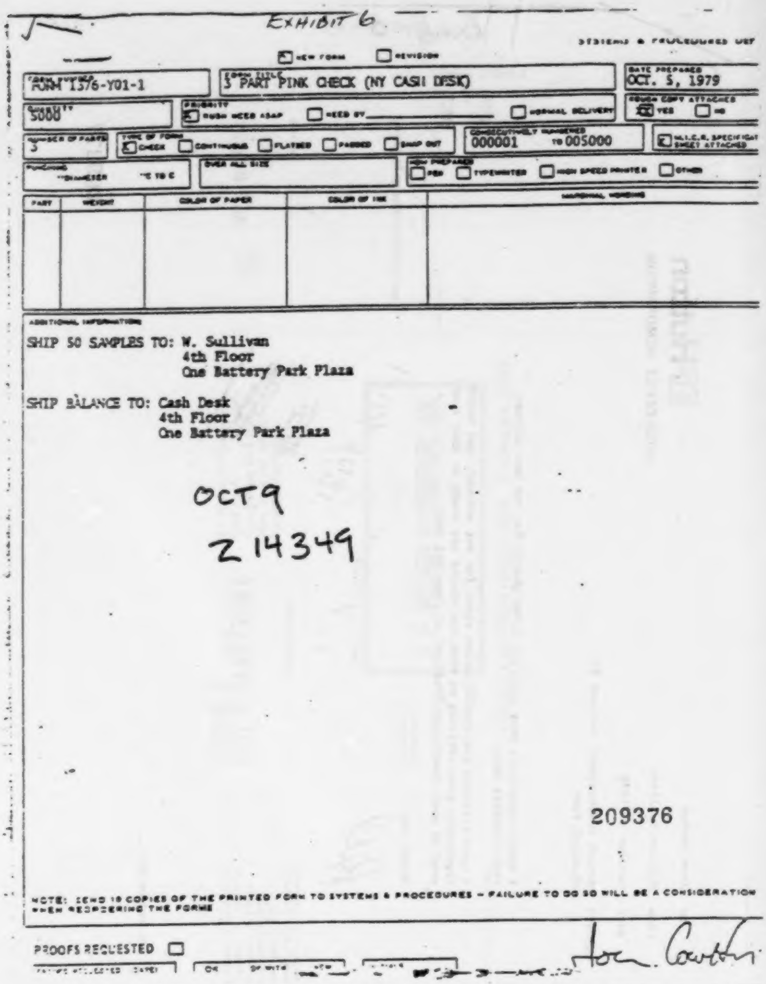


EXHIBIT 6

SYSTEMS & PROCEDURES USE

☒ NEW FORM ☐ REVISION

FORM NUMBER FORM 1376-Y01-1	FORM TITLE 3 PART PINK CHECK (NY CASH DESK)	DATE PREPARED OCT. 5, 1979
QUANTITY 5000	PRIORITY ☒ RUSH NEED ASAP ☐ NEED BY ____ ☐ NORMAL DELIVERY	ROUGH COPY ATTACHED ☒ YES ☐ NO
NUMBER OF PARTS 3	TYPE OF FORM ☒ CHECK ☐ CONTINUOUS ☐ PLATTED ☐ PADDED ☐ SNAP OUT	CONSECUTIVELY NUMBERED 000001 TO 005000 ☒ M.I.C.R. SPECIFICAT SHEET ATTACHED
PUNCHING "DIAMETER "C TO C	OVER ALL SIZE	HOW PREPARED ☐ PEN ☐ TYPEWRITER ☐ HIGH SPEED PRINTER ☐ OTHER

PART	WEIGHT	COLOR OF PAPER	COLOR OF INK	MARGINAL WORDING

ADDITIONAL INFORMATION

SHIP 50 SAMPLES TO: W. Sullivan
4th Floor
One Battery Park Plaza

SHIP BALANCE TO: Cash Desk
4th Floor
One Battery Park Plaza

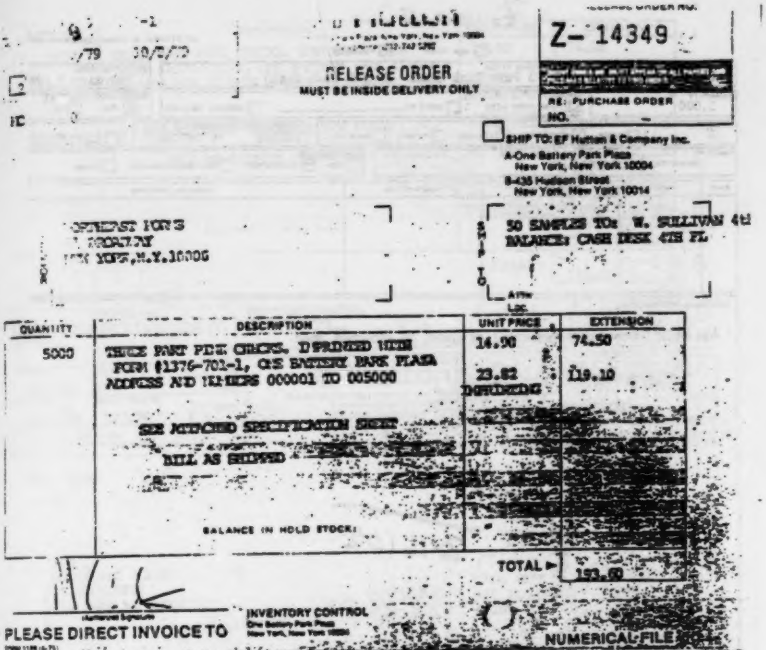
OCT9
Z14349

209376

NOTE: SEND 10 COPIES OF THE PRINTED FORM TO SYSTEMS & PROCEDURES – FAILURE TO DO SO WILL BE A CONSIDERATION WHEN REORDERING THE FORMS

PROOFS REQUESTED ☐

Tom Cawth



/79 10/5/79

RELEASE ORDER
MUST BE INSIDE DELIVERY ONLY

RELEASE ORDER NO.
Z-14349

RE: PURCHASE ORDER
NO.

☐ SHIP TO: EF Hutton & Company Inc.
A-One Battery Park Plaza
New York, New York 10004
B-435 Hudson Street
New York, New York 10014

ORTHEAST FORMS
BROADWAY
YORK,N.Y.10006

50 SAMPLES TO: W. SULLIVAN 4th
BALANCE: CASH DESK 4TH FL

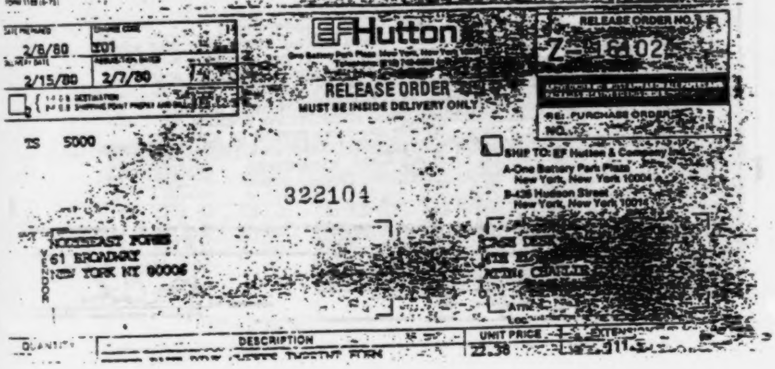
Attn
Loc.

QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
5000	THREE PART PEG. CHECKS. IMPRINTED WITH FORM #1376-701-1, ONE BATTERY PARK PLAZA ADDRESS AND NUMBERS 000001 TO 005000	14.90 23.82 IMPRINTING	74.50 119.10
	SEE ATTACHED SPECIFICATION SHEET BILL AS SHIPPED		
	BALANCE IN HOLD STOCK:		
		TOTAL ►	193.60

Authorized Signature

PLEASE DIRECT INVOICE TO
INVENTORY CONTROL
One Battery Park Plaza
New York, New York 10004

NUMERICAL FILE



DATE PREPARED	CHARGE CODE
2/8/80	201
DELIVERY DATE	REQUISITION DATED
2/15/80	2/7/80

EF Hutton
One Battery Park Plaza New York, New York

RELEASE ORDER
MUST BE INSIDE DELIVERY ONLY

RELEASE ORDER NO.
Z-16102

ABOVE ORDER NO. MUST APPEAR ON ALL PAPERS AND PACKAGES RELATIVE TO THIS ORDER

RE: PURCHASE ORDER
NO.

TS 5000

322104

☐ SHIP TO: EF Hutton & Company Inc.
A-One Battery Park Plaza
New York, New York 10004
B-435 Hudson Street
New York, New York 10014

NORTHEAST FORMS
61 BROADWAY
NEW YORK NY 10006

CASH DESK
ATTN: CHARLIE

Attn
Loc.

QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
		22.38	111

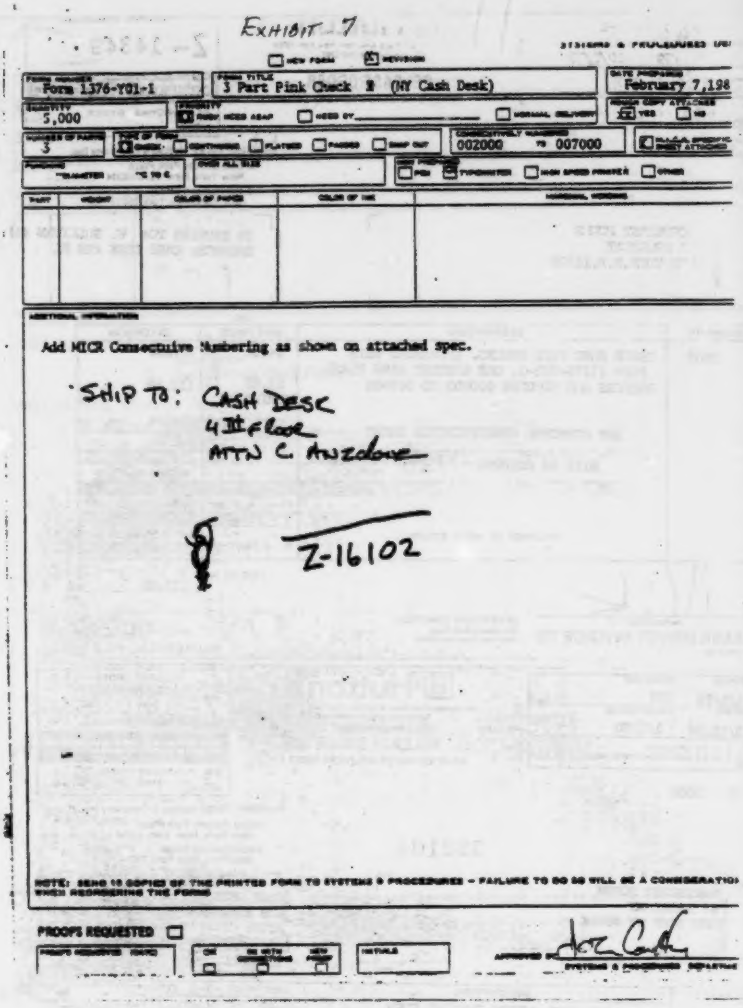


EXHIBIT 7

SYSTEMS & PROCEDURES US

☐ NEW FORM ☒ REVISION

FORM NUMBER Form 1376-Y01-1	FORM TITLE 3 Part Pink Check # (NY Cash Desk)	DATE PREPARED February 7,198
QUANTITY 5,000	PRIORITY ☒ RUSH NEED ASAP ☐ NEED BY ______ ☐ NORMAL DELIVERY	PROOF COPY ATTACHED ☒ YES ☐ NO
NUMBER OF PARTS 3	TYPE OF FORM ☒ CHECK ☐ CONTINUOUS ☐ PLATTED ☐ PADDED ☐ SNAP OUT	CONSECUTIVELY NUMBERED 002000 TO 007000 ☒ M.I.C.R. SPECIFIC SHEET ATTACHED
PUNCHING DIAMETER C TO C	OVER ALL SIZE	HOW PREPARED ☐ PEN ☐ TYPEWRITER ☐ HIGH SPEED PRINTER ☐ OTHER

PART	WEIGHT	COLOR OF PAPER	COLOR OF INK	MARGINAL WORDING

ADDITIONAL INFORMATION

Add MICR Consecutive Numbering as shown on attached spec.

SHIP TO: CASH DESK
4th Floor
ATTN C. Anzalone

Z-16102

NOTE: SEND 10 COPIES OF THE PRINTED FORM TO SYSTEMS & PROCEDURES – FAILURE TO DO SO WILL BE A CONSIDERATIO
WHEN REORDERING THE FORMS

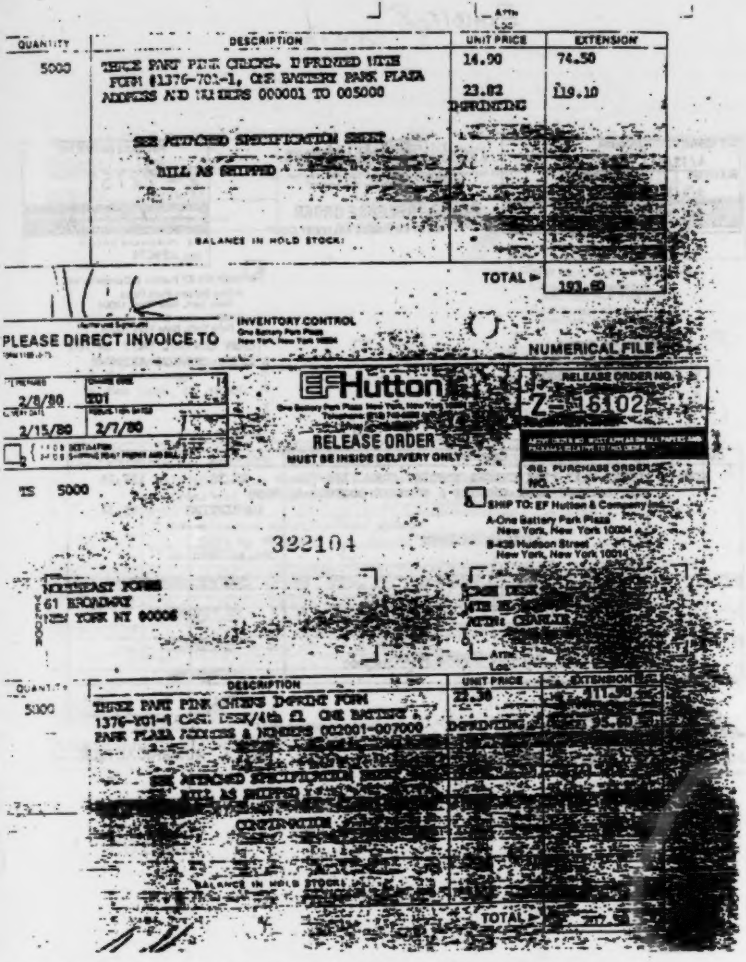
PROOFS REQUESTED ☐

PROOFS REQUESTED (DATE)

OK ☐ OK WITH CORRECTIONS ☐ NEW PROOF ☐

INITIALS

APPROVED BY
SYSTEMS & PROCEDURES DEPARTME



ATTN
LOC

QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
5000	THREE PART PINK CHECKS. IMPRINTED WITH FORM #1376-701-1, ONE BATTERY PARK PLAZA ADDRESS AND NUMBERS 000001 TO 005000	14.90 23.82 IMPRINTING	74.50 119.10
	SEE ATTACHED SPECIFICATION SHEET		
	BILL AS SHIPPED		
	BALANCE IN HOLD STOCK:		
		TOTAL ►	193.60

INVENTORY CONTROL
One Battery Park Plaza
New York, New York 10004

PLEASE DIRECT INVOICE TO

NUMERICAL FILE

EFHutton
One Battery Park Plaza New York, New York

RELEASE ORDER
MUST BE INSIDE DELIVERY ONLY

RELEASE ORDER NO.
Z-16102

ABOVE ORDER NO. MUST APPEAR ON ALL PAPERS AND PACKAGES RELATIVE TO THIS ORDER

RE: PURCHASE ORDER NO.

2/8/80	201
2/15/80	2/7/80

☐ 1 F.O.B. DESTINATION
2 F.O.B. SHIPPING POINT PREPAY AND BILL

TS 5000

322104

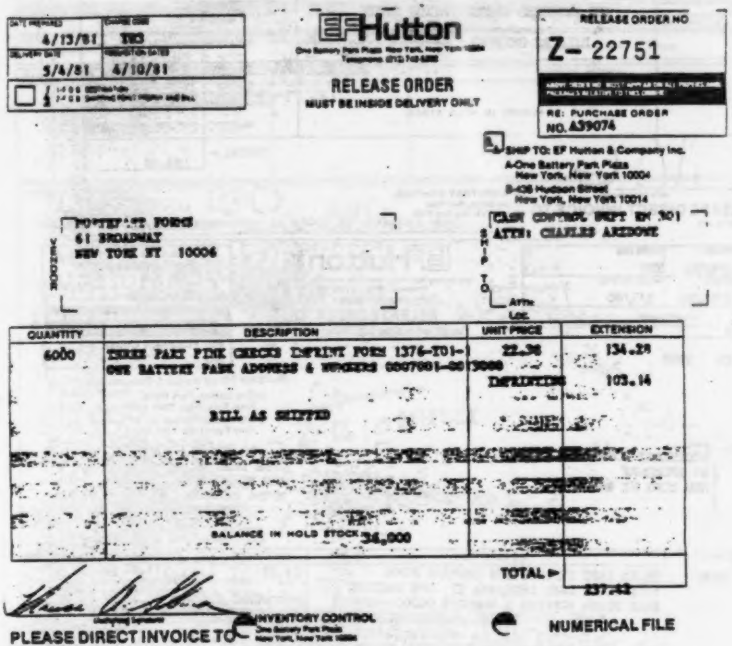
VENDOR
NORTHEAST FORMS
61 BROADWAY
NEW YORK NY 00006

☐ SHIP TO: EF Hutton & Company Inc.
A-One Battery Park Plaza
New York, New York 10004
B-435 Hudson Street
New York, New York 10014

CASH DESK
4TH FLOOR
ATTN: CHARLIE
Attn
Loc

QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
5000	THREE PART PINK CHECKS IMPRINT FORM 1376-701-1 CASH DESK/4th FL ONE BATTERY PARK PLAZA ADDRESS & NUMBERS 002001-007000	22.30 IMPRINTING	111.50 95.80
	SEE ATTACHED SPECIFICATION SHEET		
	BILL AS SHIPPED		
	CONTINUATION		
	BALANCE IN HOLD STOCK:		
		TOTAL ►	207.30

Exhibit 8



DATE PREPARED 4/13/81	CHARGE CODE TH3
DELIVERY DATE 5/4/81	REQUISITION DATED 4/10/81

EF Hutton

RELEASE ORDER

MUST BE INSIDE DELIVERY ONLY

RELEASE ORDER NO

Z- 22751

RE: PURCHASE ORDER
NO. A39074

SHIP TO: EF Hutton & Company Inc.
A-One Battery Park Plaza
New York, New York 10004
B-436 Hudson Street
New York, New York 10014

VENDOR
[illegible] FORMS
61 BROADWAY
NEW YORK NY 10006

SHIP TO
CASH CONTROL DEPT RM 301
ATTN: CHARLES AREDONE
Attn:
Loc.

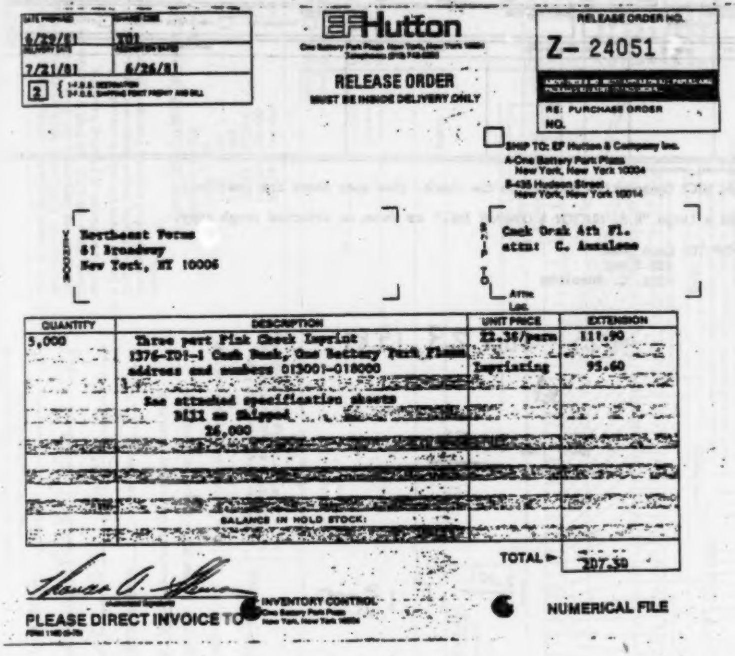
QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
6000	THREE PART PINK CHECKS IMPRINT FORM 1376-T01-1 ONE BATTERY PARK ADDRESS & NUMBERS 0007001-0013000	22.38	134.28
		IMPRINTING	103.14
	BILL AS SHIPPED		
	BALANCE IN HOLD STOCK 36,000		
		TOTAL ▶	237.42

Authorized Signature

PLEASE DIRECT INVOICE TO — INVENTORY CONTROL

NUMERICAL FILE

Exhibit 9



6/29/81	ZO1
7/21/81	6/26/81

2 { 1-F.O.B. DESTINATION
2-F.O.B. SHIPPING POINT PREPAY AND BILL

EF Hutton

One Battery Park Plaza New York, New York 10004

RELEASE ORDER

MUST BE INSIDE DELIVERY ONLY

RELEASE ORDER NO.

Z- 24051

RE: PURCHASE ORDER NO.

☐ SHIP TO: EF Hutton & Company Inc.
A-One Battery Park Plaza
New York, New York 10004
B-435 Hudson Street
New York, New York 10014

VENDOR
Northeast Forms
61 Broadway
New York, NY 10006

SHIP TO
Cash Desk 4th Fl.
attn: C. Annalone

Attn
Loc.

QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
5,000	Three part Pink Check Imprint 1376-ZO1-1 Cash Desk, One Battery Park Plaza address and numbers 013001-018000	22.38/perm Imprinting	111.90 95.60
	See attached specification sheets Bill as Shipped 26,000		
	BALANCE IN HOLD STOCK:		

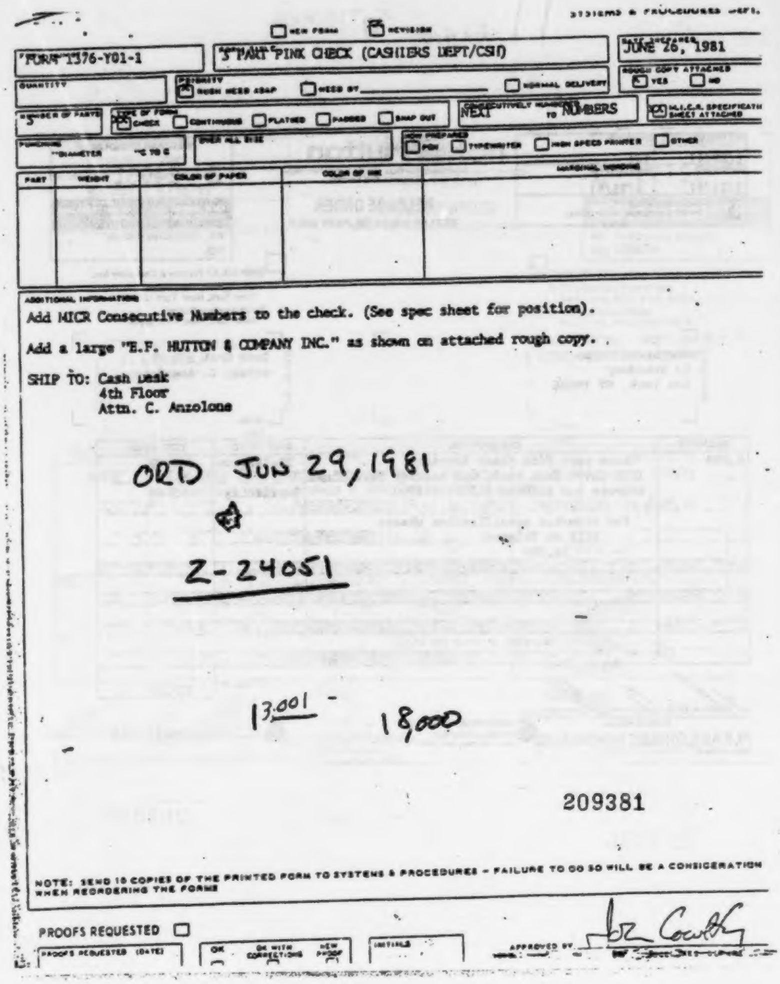
TOTAL ► 207.50

Thomas O. Shum

PLEASE DIRECT INVOICE TO INVENTORY CONTROL
One Battery Park Plaza
New York, New York 10004

NUMERICAL FILE

209390



SYSTEMS & PROCEDURES DEPT.

☐ NEW FORM ☒ REVISION

FORM # 1376-Y01-1

FORM TITLE 3 PART PINK CHECK (CASHIERS DEPT/CSH)

DATE PREPARED JUNE 26, 1981

ROUGH COPY ATTACHED ☒ YES ☐ NO

QUANTITY

PRIORITY ☒ RUSH NEED ASAP ☐ NEED BY ________ ☐ NORMAL DELIVERY

NUMBER OF PARTS 3

TYPE OF FORM ☒ CHECK ☐ CONTINUOUS ☐ PLATED ☐ PADDED ☐ SNAP OUT

CONSECUTIVELY NUMBERED NEXT TO NUMBERS

☒ M.I.C.R. SPECIFICATION SHEET ATTACHED

PUNCHING "DIAMETER "C TO C

SHEET ALL SIZE

HOW PREPARED ☐ PEN ☐ TYPEWRITER ☐ HIGH SPEED PRINTER ☐ OTHER

PART	WEIGHT	COLOR OF PAPER	COLOR OF INK	MARGINAL WORDING

ADDITIONAL INFORMATION

Add MICR Consecutive Numbers to the check. (See spec sheet for position).

Add a large "E.F. HUTTON & COMPANY INC." as shown on attached rough copy.

SHIP TO: Cash Desk
4th Floor
Attn. C. Anzolone

ORD JUN 29, 1981

Z-24051

13,001 - 18,000

209381

NOTE: SEND 10 COPIES OF THE PRINTED FORM TO SYSTEMS & PROCEDURES - FAILURE TO DO SO WILL BE A CONSIDERATION WHEN REORDERING THE FORMS

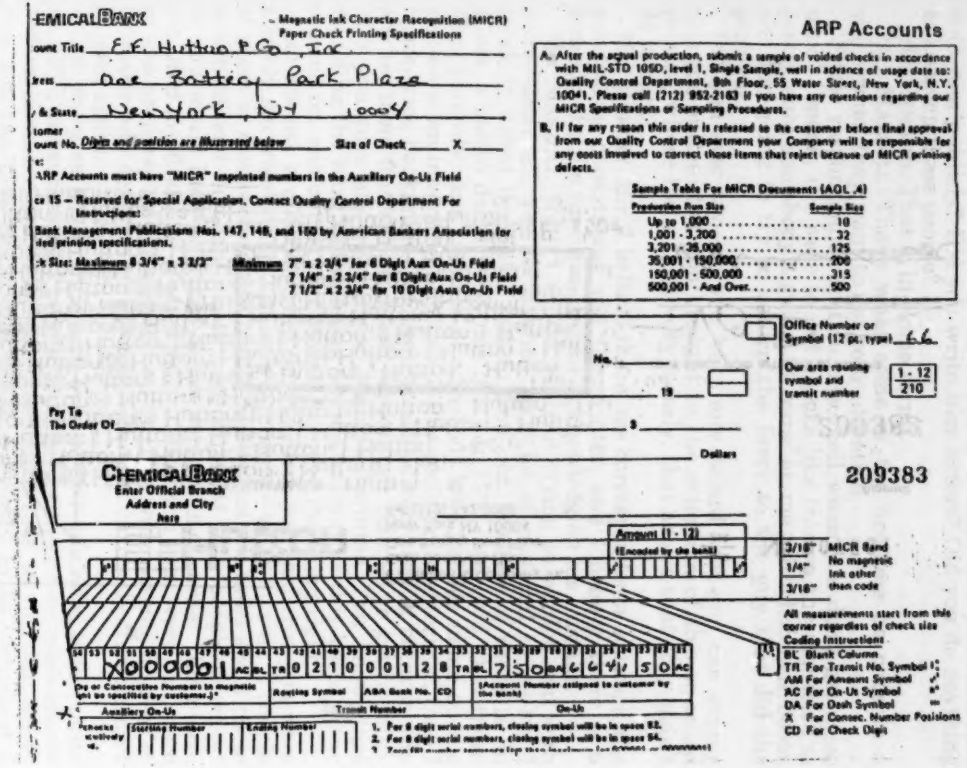
PROOFS REQUESTED ☐

PROOFS REQUESTED (DATE)

OK ☐ OK WITH CORRECTIONS ☐ NEW PROOF ☐

INITIALS

APPROVED BY



-EMICALBANK

– Magnetic Ink Character Recognition (MICR)
Paper Check Printing Specifications

ARP Accounts

ount Title E.F. Hutton & Co, Inc

ress One Battery Park Plaza

& State New York, NY 10004

tomer
ount No. *Digits and position are illustrated below* Size of Check ______ X ______

e:
ARP Accounts must have "MICR" imprinted numbers in the Auxiliary On-Us Field

ce 15 – Reserved for Special Application. Contact Quality Control Department For Instructions:

Bank Management Publications Nos. 147, 148, and 150 by American Bankers Association for ded printing specifications.

k Size: Maximum 8 3/4" x 3 2/3" Minimum 7" x 2 3/4" for 6 Digit Aux On-Us Field
7 1/4" x 2 3/4" for 8 Digit Aux On-Us Field
7 1/2" x 2 3/4" for 10 Digit Aux On-Us Field

A. After the actual production, submit a sample of voided checks in accordence with MIL-STD 105D, level 1, Single Sample, well in advance of usage date to: Quality Control Department, 9th Floor, 55 Water Street, New York, N.Y. 10041. Please call (212) 952-2163 if you have any questions regarding our MICR Specifications or Sampling Procedures.

B. If for any reason this order is released to the customer before final approval from our Quality Control Department your Company will be responsible for any costs involved to correct those items that reject because of MICR printing defects.

Sample Table For MICR Documents (AQL .4)

Production Run Size	Sample Size
Up to 1,000	10
1,001 - 3,200	32
3,201 - 35,000	125
35,001 - 150,000	200
150,001 - 500,000	315
500,001 - And Over	500

Office Number or Symbol (12 pt. type) 66

No. ______

______ 19 ___

Our area routing symbol and transit number 1 - 12 / 210

Pay To
The Order Of ______ $ ______

______ Dollars

CHEMICALBANK
Enter Official Branch
Address and City
here

209383

Amount (1 - 12)
(Encoded by the bank)

3/16" MICR Band
1/4" No magnetic ink other than code
3/16"

54	53	52	51	50	49	48	47	46	45	44	43	42	41	40	39	38	37	36	35	34	33	32	31	30	29	28	27	26	25	24	23	22	21
		X	0	0	0	0	0	1	AC	BL	TR	0	2	1	0	0	0	1	2	8	TR	BL	7	5	0	DA	6	6	4	/	5	0	AC

ng or Consecutive Numbers to magnetic ght be specified by customer.)* | Routing Symbol | ABA Bank No. | CD | | (Account Number assigned to customer by the bank)

Auxiliary On-Us | Transit Number | On-Us

*checks ecutively d.

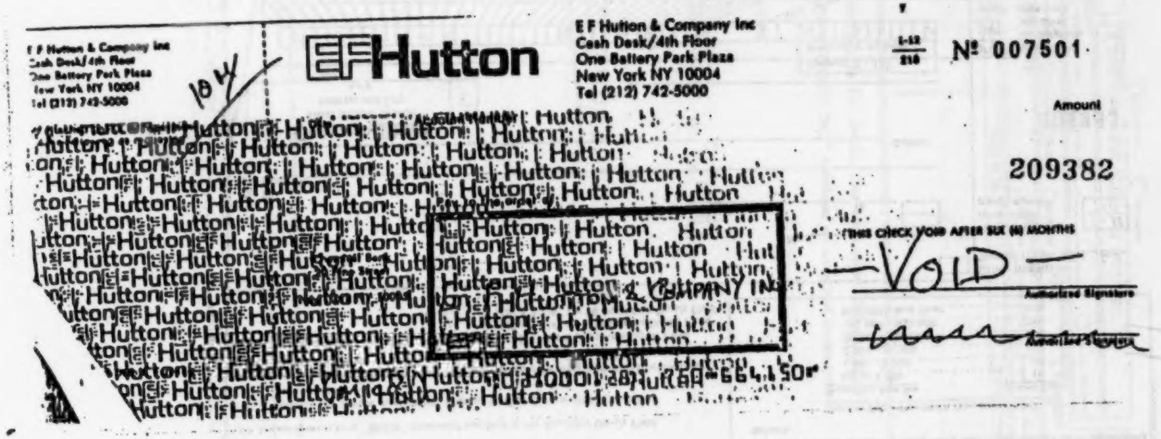
Starting Number | Ending Number

1. For 6 digit serial numbers, closing symbol will be in space 52.
2. For 8 digit serial numbers, closing symbol will be in space 54.
3. Zero fill number sequence [illegible]

All measurements start from this corner regardless of check size

Coding Instructions

- BL Blank Column
- TR For Transit No. Symbol ⑆
- AM For Amount Symbol ⑇
- AC For On-Us Symbol ⑈
- DA For Dash Symbol ⑉
- X For Consec. Number Positions
- CD For Check Digit



E F Hutton & Company Inc
Cash Desk/4th Floor
One Battery Park Plaza
New York NY 10004
Tel (212) 742-5000

10 ¼

EF Hutton

E F Hutton & Company Inc
Cash Desk/4th Floor
One Battery Park Plaza
New York NY 10004
Tel (212) 742-5000

1-12
210

№ 007501

Amount

209382

& COMPANY INC

THIS CHECK VOID AFTER SIX (6) MONTHS

—VOID—

Authorized Signature

Authorized Signature

0210001 28 260-664150

Mr. **Mazzoli**. And, second, give me some idea: Did you raise hell with him publicly? Did you write him letters? Did you do anything to kneecap these people?

Mr. **Hughes**. That is in Rome terms.

Mr. **Mazzoli**. That's what some of the brothers do once in a while when they want to get your attention.

Whose responsibility is it to raise hell when you don't get a job done? I mean, if I were to put checks like this on the market, I'm pretty sure somebody's going to come at me with hob-nail boots, and I'm going to try to return the favor to the guy that did the problem.

Did you ever try—do you have any record that you can supply this committee that you brought to the attention of this so-called printer, whose term I use very loosely, that shows that they didn't do it right?

Mr. **Morley**. Sir, I believe there are correspondence between the purchasing department and the printer, and I believe there is a letter in the file from the printer acknowledging his mistake.

Mr. **Mazzoli**. Well, I would, without trying to burden you with more—after all, you've coughed up a lot of material here—but I think it would be useful just to find out. Because if there is, in effect, a memo dated 1985, not 1981, or 1982, but 1985, that there is, apparently, in a position of somebody who put his name on the line here, an intentional misuse of this coding characteristic, then I think some background on that would be very useful; because otherwise, then, frankly—and just pardon me, then—I've got to think that you guys are in collusion with the printer. You know, that would be the next logical thing for me to think if this keeps going on, and on, and on but nobody can ever get the thing right.

Let me ask a question here. Mr. Fomon, you said that you were terribly surprised—and I'm sure you were—when it took a couple of years or more before you really, finally, got the news about these activities, and that you would have expected your people to report or you would have expected to get some things earlier this morning. And my first line of questions to all of you was, were you more or less prepared to put yourself on the line with varying degrees of intensity and devotion to the principle that currently this couldn't happen again.

Can you give me a quick once-over of how you now, today, June 19, 1985, are sure that if people don't report their own misfeasance and malfeasance and criminal intent and greed to you that somehow you can pick it out and you're not going to be victimized 5 years later by some other congressional committee?

Mr. **Fomon**. I cannot. Maybe Mr. Morley can.

Mr. **Mazzoli**. Pardon me if I go back to the spring of 1982, and you're not sure but that you're now being pulled to and from by some mid-level guy down below.

Mr. **Fomon**. I have moved the operation, as I stated, out of the operations department into the control department. It has different management. As a matter of fact, Mr. Morley is no longer in charge of the money mobilization. We've hired, effective July 1, a new man to fulfill the treasury operations.

Mr. **Mazzoli**. Let me ask you this. I'm sure this has got to be an agony for you, an esteemed business person being drawn through this for the last weeks so much, your reputation, the company's reputation, it's got to be a chagrining experience, chastening.

Because it is this, because there has been such a burning, seering experience, you have not, right now, done something that would guarantee that at least from this time on you're not going to be left dangling and twisting slowly in the wind? Do you mean to tell me that you're——

Mr. **FOMON.** We're working. We're going to need a computer program to do this. We're going to have to make different arrangements, arrangements with different banks.

In retrospect, it was silly to leave the banking decisions to the various regions.

Mr. **MAZZOLI.** Mr. Fomon, just may I ask you a question, just out of curiosity?

Have you had what in the army we used to call a show-down inspection of E.F. Hutton?

Mr. **FOMON.** What is that?

Mr. **MAZZOLI.** Well, for those who haven't been in the army, that is when the field first sergeant, and the first sergeant, and the company commander fall everybody out in the street and they examine you personally, from top to bottom, go into your cubicle, and they examine your footlocker and your medal locker, a showdown inspection.

What have you done and what are you doing?

I mean, have you had anything that is comparable to a show-and-tell with your people since this thing?

Mr. **FOMON.** I have not, personally, but any number of my employees have.

Mr. **MAZZOLI.** Well, just very quickly if I could, Mr. Castellano, you know since your head is, to some extent, exposed here, I mean are you doing anything with the people in your employ, in your direction, that would guarantee that it is not up to their basic sense of honesty and judgment to bring to your attention but you're trying to figure out in your own self-interest what they are doing?

Mr. **CASTELLANO.** Yes, I am, sir. I can tell you what controls that we have put in.

Mr. **MAZZOLI.** If you could, simplify it, because I do appreciate that at least you're saying yes, you're not now just simply trusting the people down below in their excess of zeal, and decency, and honesty to bring to your attention what they are doing. Right? You're doing something to protect yourself.

Mr. **CASTELLANO.** Yes.

Mr. **MAZZOLI.** Mr. Morley, are you doing something now, in your new position, to protect yourself?

Mr. **MORLEY.** Yes. I am, sir.

Mr. **MAZZOLI.** Mr. Lynch, are you trying to protect yourself now in any fashion?

Mr. **LYNCH.** I'm not directly involved in the cash mobilization process, but I think the procedures that we agreed to with the Justice Department and the injunction, in themselves, established controls, because we will have specific agreements with each of the banks as to our drawdown procedures, currently we are rigidly enforcing a very standard, basic drawdown procedure.

The internal audit scope has been increased to review these activities on a local basis. We've put new people into place who are experts in this area. I think we've done a lot to close the gaps that existed in our system up until recently.

Mr. **Mazzoli**. Before we end it this afternoon I want to be sure that we put in a word for what I think is, in part, the cause here, and that is the commercial bank tendency not to give us the use of our money for a long, long time. And a lot of what you all were doing is trying to protect yourself against the banks' use of your money and their windfall at your expense. So, you tried to play this incredibly complicated and convoluted game in order that they don't get the drop on you. And I sympathize with that, because I think the banks have entirely gone beyond the pale when it comes to what has been going on or that you get the best use of your money.

Let me start with you, Mr. Morley, are you aware of anything now that would be tantamount to something like what we have that is simply a reaction on your part to the way the banking regulations and laws are constructed?

Mr. **Morley**. No, sir. There is nothing that I am aware of that is anything. We are at a very plain, conservative type approach that is being highly controlled. And we hope to institute further controls as we go forward.

Mr. **Mazzoli**. Let me ask Mr. Castellano.

Are you aware of anything now that is an effort to, in effect, "have your cake and eat it too?"

Mr. **Castellano**. No, I am not, sir.

Mr. **Mazzoli**. Mr. Fomon, are you aware of anything?

I might say you are the only one of the four panelists who said that you are, apparently, willing to go along with the people who are reporting to you; which, I guess, is——

Mr. **Fomon**. That is correct.

Mr. **Mazzoli**. I am proud of you for that.

Are you aware, on that basis, of what anyone has told you, I guess, of what E.F. Hutton is doing to maybe finesse the problem of floats and check——

Mr. **Fomon**. Under our inspection it will be impossible for anybody to finesse anything.

Mr. **Mazzoli**. Mr. Lynch.

Mr. **Lynch**. That is basically the point I tried to make a minute ago, that the tight controls in place now prevent any finesse of the banks. In fact, I think the banks are benefitting currently from substantially more flow than they are accustomed to.

Mr. **Mazzoli**. That's right. And I hope that somehow we can pass a bill up here that we get things back.

Mr. **Hughes**. The gentleman's time has expired.

The gentleman from Connecticut.

Does the gentleman from Connecticut want to yield to the gentleman from Ohio?

Mr. **Morrison**. I would be happy to yield.

Mr. **Feighan**. Thank you.

My concern about your responses, which I think to be genuinely serious, is that there is, perhaps, continuation of these practices that you may not be aware of.

In a letter dated April 12, 1985, from the Lincoln First Chase Bank of Rochester, NY, the corporate banking officer stated to Mr. Morley as follows:

"Apparently, the E.F. Hutton office in Binghamton asked our people in Binghamton to certify a check for approximately $104,000. While there was a book balance of over $140,000, your collected balance was overdrawn over $500,000. I believe we receive such requests four to five times per year," et cetera, et cetera. Then it goes on to admonish Mr. Morley's office that: "We must have good funds in the account in order to certify a check."

I guess we just wonder if it's ever really going to end.

Mr. HUGHES. Would the gentleman want to offer that for the record?

Mr. FEIGHAN. I would like to.

Mr. HUGHES. Without objection.

[The aforementioned documents follow:]

CHASE
Lincoln First

Chase Lincoln First Bank, N.A.
One Lincoln First Square
Rochester, New York 14643

Nat'l Dept

Excessive drawdown

April 12, 1985

Mr. Thomas Morley
EF Hutton Company
One Battery Park Plaza
New York, NY 10004

Dear Mr. Morley:

Enclosed please find our debit advices to account number 024-218-0 in the amount of $579.93 and account number 022-928-6 in the amount of $772.83. These represent payment for shortfall in demand deposit balances to cover services on each account from January through March.

As I stated in my letter to you of March 12, we will be taking the necessary steps to initiate an automatic charge at month end beginning with the second quarter.

I would also like to bring another situation to your attention. Apparently, the EF Hutton office in Binghamton asked our people in Binghamton to certify a check for approximately $104,000. While there was a book balance of over $140,000, your collected balance was overdrawn over $500,000. I believe we receive such requests four to five times per year. Although I approved the certification of this item, I hope you will communicate to your offices that we must have good funds in the accounts in order to certify a check. I will be more than happy to discuss this with you if you wish.

Please feel free to call me if I can answer any questions for you.

Sincerely,

Diana DeMarco

Diana DeMarco
Corporate Banking Officer
(716)258-5442

dd/mp
Enc.
xc: Nancy Smith - Main Office/Binghamton

Mr. **Hughes**. The gentleman from Connecticut.

Mr. **Morrison**. Thank you, Mr. Chairman.

I guess what is left unclear to me after the most recent line of inquiry is what it is that the line is that you're not crossing that you used to cross. And I'm going to start with you, Mr. Fomon, if you can help me with respect to that.

Are you still—and start at the branch level—are you still drawing funds in excess of what has been collected funds in those accounts at the time that you draw those checks?

Mr. **Fomon**. No.

Mr. **Morrison**. Collected funds only on the banks' books as collected; is that correct? Collected funds only——

Mr. **Fomon**. Tom Morley.

Mr. **Morley**. May I comment——

Mr. **Morrison**. Please.

Mr. **Morley** [continuing]. On what we're doing now?

Mr. **Morrison**. Well, answer my question. I don't want to—it's complicated enough, so I want to take it a little piece at the time.

Mr. **Morley**. I'll try to make it—we think there are collective funds, and one of the problems is when the availabilities pass on to us. What we do now is that we—say that the check is in the same Federal Reserve district, that will be 1-day availability, meaning that they will collect that check in one day. So, if our deposit has—creates a deposit that may have $50,000 of which $40,000 is in the same Federal Reserve district, we'll take out that $40,000 today, assuming that $40,000 will be made available to us tomorrow.

Mr. **Morrison**. Mr. Morley.

Mr. **Morley**. How do I say this?

If the bank changes availabilities scheduled tomorrow and say that you're getting 2 days in the same Federal Reserve district, we have no control over it. But we're attempting to do as good of a job with those parameters that I just set forth. We have said if it's in the same Federal Reserve district, we'll use 1-day availability, which seems to me——

Mr. **Morrison**. The decision—you're making the decision or the bank, that is your contractual arrangement with the bank under their collection policies, or what?

Mr. **Morley**. Well, if the bank has presented us with a collection policy, we will—the local offices are instructed to follow that. But if the bank has not, we will use the same Federal Reserve district as one day.

Mr. **Morrison**. So, in other words, you are not seeking to draw down any funds that are uncollected at the time of the issuance of the check.

Mr. **Morley**. That's true. If you say I put in $10,000 and I'll draw out $10,000 today, that $10,000——

Mr. **Morrison**. You're drawing 1 day ahead, is that what you're saying?

Mr. **Morley**. No; we're drawing 1 day ahead.

Mr. **Morrison**. What I'm saying, you're drawing 1 day ahead of what the bank would call collected, because it says 24 hours and you're drawing the same day.

Mr. **Morley**. That's right.

Mr. **Morrison**. So, you're drawing down 1 day ahead on your current policy.

Mr. **Morley**. I'm drawing down the same day. I put $10,000 in, the bank is going to have that money collected tomorrow.

Mr. **Morrison**. I understand.

Mr. **Morley**. OK, then we'll take the check——

Mr. **Morrison**. You're drawing down 1 day ahead of the time that the bank would give you availability; is that what you are saying?

Mr. **Lynch**. The implication is that a bank—would reach the bank one day later.

Mr. **Morrison**. I understand, I understand float, but what I'm trying to get straight is what your policy is now, is it different from what it was then. What it was then included drawing more than was ever going to be collected funds, in many instances.

Mr. **Fomon**. It would be illegal——

Mr. **Morrison**. There were many instances in which you drew more than would ever be collected funds, based on the deposit you were making; is that correct?

Mr. **Fomon**. True. True.

Mr. **Morrison**. And you're also making those drawdowns without regard to this timing that we're talking about now.

Mr. **Morley**. That was correct under the authorized drawdown worksheet, yes.

Mr. **Morrison**. Now, when was it that this, what you are stating now, is this policy that you just stated set in writing somewhere?

Mr. **Morley**. Yes, sir, it is.

Mr. **Morrison**. Is that among the documents that we've received or not?

Mr. **Hughes**. We have not received that document.

Mr. **Morley**. I'll see that you get it.

Mr. **Morrison**. That document says that, basically, you'll collect 1 day ahead, is that what it says?

Mr. **Morley**. That outlines, as far as what I said, determining, that's correct.

Mr. **Morrison**. When did this become effective?

Mr. **Morley**. This became effective I believe it was the middle—the end—of May.

Mr. **Morrison**. 1985?

Mr. **Morley**. 1985.

Mr. **Morrison**. Now, between the time of December 1981 or February 1982, what was the policy for that 3-year period?

Mr. **Morley**. We consulted Arthur Young.

Let me go back. In May 1982, we just drew down the amount of our deposits.

Mr. **Morrison**. The same day?

Mr. **Morley**. The same day.

Mr. **Morrison**. Make a deposit drawdown in that amount?

Mr. **Morley**. Leaving the bank service requirement that we thought was adequate to support our services.

Mr. **Morrison**. You mean leaving them with a balance?

Mr. **Morley**. Leaving them with a balance, correct.

Mr. **Morrison**. On your books or their books?

Mr. Morley. On our books as well as their books. I believe that was the policy that we—well, we drew down, I believe we drew down, zero.

Mr. Morrison. On your books?

Mr. Morley. On our books. We would not have a negative credit balance on our books, we just basically drew down to zero.

Mr. Morrison. That was your policy from when in 1982?

Mr. Morley. From May until, I believe, October.

Mr. Fomon. 1982?

Mr. Morrison. Is that right?

Mr. Morley. I believe it's 1982.

Mr. Morrison. Is there writing that supports that policy?

Mr. Morley. Yes, sir.

Mr. Morrison. Can we receive that?

Mr. Morley. Yes, sir.

[Information follows:]

#7

EFHutton

INTER-OFFICE MEMORANDUM

TO Regional Operations Managers

FROM Thomas P. Morley

DATE June 13, 1985

SUBJECT Drawdown Worksheet

Attached is an interim authorized drawdown worksheet that should be used by all branches until your banks have signed the standard bank consent form.

This worksheet allows the branches to drawdown daily the immediately available deposits and all checks drawn on banks in the same Federal Reserve district as the local branch bank. The remaining deposits are treated as having two day availability and are not drawn down until the following business day.

Please distribute the worksheet to your branches and instruct them to use it until the consent form is signed and returned. In addition, the branches should also forward to you copies of the daily worksheets at the end of every week.

Enclosure

THOMAS P. MORLEY

cc: P. Hines
D. Denmark
R. Genin
R. Brunton
H. van Hengel
Regional Cashiers

Used From June 13 1985
To Present

1. Previous Days Closing EFH Ledger Balance (Should be positive Balance, if negative call Regional Cashier) +______

2. Deposits drawn on Local Fed Reserve District, plus incoming wires and cash deposits +______

3. Local Checks Issued -______

4. Local Bank Service Requirement -______

5. Sub Total - If negative draw a BRC for the amount on line 5 and enter this amount on line 6 as plus. If line 5 is plus enter this amount on line 7 to be drawn down ______

6. BRC deposit +______

7. Drawdown -______

8. Sub Balance (should be zero if not call regional cashier) ______

9. Balance of Today's Deposits (Total deposits less line 2) +______

10. Late Deposits +______

11. Sub Total ______

12. Add Back Line 4 +______

13. Closing EFH Ledger Balance (line 11 plus line 12, should always be positive) ______

CAHILL GORDON & REINDEL
EIGHTY PINE STREET
NEW YORK, N.Y. 10005

FLOYD ABRAMS
ROGER ANDRUS
HENRY G. BISGAIER*
CARL H. BORNMANN
P. KEVIN CASTEL
WALTER C. CLIFF, P.C.
BENJAMIN J. COHEN
JOSEPH P. CONWAY
MARSHALL COX
THOMAS F. CURNIN
W. LESLIE DUFFY
RAYMOND L. FALLS, JR.
PATRICIA FARREN
BART FRIEDMAN
CIRO A. GAMBONI
CHARLES A. GILMAN
STEPHEN A. GREENE
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*ADMITTED D. C. ONLY
**ALSO ADMITTED ENGLAND AND JAMAICA
***ADMITTED FRANCE ONLY

WRITER'S DIRECT NUMBER
(212) 701-3609

2 copies

May 3, 1985

Re: Hutton - F Matter

Dear Tom:

Pursuant to Paragraph 5 of the Final Judgment of Permanent Injunction entered yesterday, the following wire should be sent to all branches immediately:

> "FROM TODAY, AND UNTIL FURTHER NOTICE, ALL USE OF THE DRAWDOWN SHEET IS TO CEASE. THE AMOUNT OF EACH DAY'S DRAWDOWN CHECK IS TO BE COMPUTED ONLY, REPEAT ONLY, AS FOLLOWS:
>
> > OPENING GENERAL LEDGER (CHECK BOOK) BALANCE PLUS TODAY'S DEPOSITS PLUS TODAY'S CREDIT MEMORANDA FROM BANK LESS TODAY'S LOCAL CHECKS OR WITHDRAWALS LESS TODAY'S DEBIT MEMORANDA FROM BANK.
>
> IF THE AMOUNT IS NEGATIVE, DO NOT DRAWDOWN TODAY BUT INSTEAD DEPOSIT A U.S. TRUST CHECK IN THAT AMOUNT TO BRING THE GENERAL LEDGER BALANCE TO ZERO."

Ed Krugman of our office has revised this with Tom Morley and has told Morley to call you if he has any questions.

Sincerely,

Tom Curn

Thomas F. Curnin

Thomas W. Rae, Esq.
E.F. Hutton & Company Inc.
One Broadway - 3rd Floor
New York, NY 10004

BY HAND

cc: Mr. Thomas Morley

EFHutton

EF Hutton & Company Inc
One Battery Park Plaza
New York, New York 10004
Tel. (212) 742-5247

Memo from **Norman M. Epstein**-*Executive Vice President and Director*

5/28/82

Tom Rae---

Tom,

I would like to implement the attached draw-down procedure by the middle of June.

Since I will need approximately one week to get this integrated and installed in the branch system, I would appreciate it if you would get back to me by June 7th.

Norm

NE/eb

cc. G. Ball
R. Genin
R. Ross
T. Morley ✓

[illegible]	Column A Books	Column B Good Funds
1. Call Bank for Opening Ledger Balance	[redacted]	+
2. EFH Opening Ledger Balance (Yesterday's line 19)	+	−
3. Yesterday's Draw down (Yesterday's line 16)	[redacted]	−
4. Yesterday's Late Deposits (Yesterday's line 18)	[redacted]	+
5. Immediately available deposits (wires in, cash, checks drawn on your bank deposited to the same bank)	+	+
6. All Other Deposits	+	[redacted]
7. Local Checks Issued & Funds Wired Out	−	−
8. Normal Service Requirement	[redacted]	−
9. Special Service Requirement	[redacted]	−
10. Sub Total	[redacted]	
11. Thursday Adjustment (Other days 0) *	[redacted]	+
12. Friday Adjustment (Other days 0) **	[redacted]	−
13. Sub Total		
14. On Friday, if line 13 Col B is minus, contact your regional cashier, (who will wire in Fed Funds) and enter amount here	+	+
15. Sub Total		
16. Draw down ***	−	[redacted]
17. Branch Reimbursement Check ***	+	[redacted]
18. Late Deposits	+	[redacted]
19. Closing N/L Balance		

* On Thursday, if line 10 column B is minus, enter 2/3 of that number.
If line 10 column B is plus, enter 0.

** On Friday, if line 10 column B was plus on Thursday, enter 2/3 of that number. If Thursday's line 10 column B was minus, enter 0.

*** Look at line 15:
(1) If Col A and B are both plus, draw down the total and enter on line 16.
(2) If Col A and B are both minus, issue BRC for the total and enter on line 17
If Col A is plus and B is minus, then net the two.
✓ If the total is plus, draw down and enter on line 16;
If the total is minus, issue a BRC and enter on line 17.
If Col A is minus and B is plus, issue a BRC for A and enter on line 17, and draw down B and enter on line 16.

Mr. **Hughes**. We have not received that.

We have not received any documents that we requested. We have requested those documents specifically which emanated from headquarters, dealing with practices involving money mobilization.

Mr. **Morrison**. OK, so now we've got—we now know what you did as of May 1985 and we know something from May 1982 to October 1982.

What about the intervening period?

Mr. **Morley**. In the interim period, between May and October, we hired Arthur Young to come in and develop and approve a drawdown worksheet that would be used by our branches.

Mr. **Morrison**. And what is the fundamental concept behind that drawdown worksheet?

Mr. **Morley**. The drawdown worksheet is one that does take into effect immediately available funds as well as accounts for the float in the system.

Mr. **Morrison**. Does it drawdown below zero on your books?

Mr. **Morley**. Yes, sir.

Mr. **Morrison**. And have you supplied us with—is there a writing that embodies this policy?

Mr. **Morley**. Yes, sir.

Mr. **Morrison**. Would you expect that the overdrafts under this new policy would be higher or lower than the overdrafts under the previous activities?

Mr. **Morley**. The previous activity being——

Mr. **Morrison**. Well, you started this in October 1982. Before October—before May 1982, we had activities which included things that have been conceded to be illegal. Then we had this period where, if I understand you correctly, you went back in the other direction, you went to a more conservative situation, you never overdrew on your own, your checkbook was always zero.

Mr. **Morley**. Yes, sir.

Mr. **Morrison**. Now you went to a system where your checkbook was always negative under this new system. In effect, in October 1982, was your check book more or less negative than it used to be before May 1982?

Mr. **Morley**. I don't have the numbers as far as would they be higher or lower in 1982.

Mr. **Morrison**. Well, I'm looking at some reconciliation statements from the Commonwealth National Bank of Harrisburg, PA, and during the period of the allegedly and concededly, I guess, criminal activities, we have book balances of yours that are negative in general and range from $14,000 to $84,000. And when I look at the later period starting in July 1982 and beyond, we are now seeing figures of overdrafts like $700,000 one point, $3 million, $6 million, $700,000, $496,000, $1.4 million.

I'm just—the reason I know you're not looking at this particular piece of paper, and I don't expect you to explain it, but what I'm curious about is, you're telling me that you fixed it, and yet it seems to me like you're doing more overdrafting, not less, when I look at this information which suggests that maybe the fix is worse than what was fixed.

Do you know anything about this account? Have you looked at it?

Mr. Morley. No, sir, I haven't.

Mr. Morrison. I assume we got this information from you.

Mr. Chairman, I don't know whether it's appropriate for these particular documents to be included in the record or not, to do that at this point.

Mr. Hughes. The documents will be received into the record.

[The information follows:]

RECONCILIATIONS
COMMONWEALTH NATIONAL BANK
HARRISBURG, PA

p1of3

DATE	BANK BALANCE	BOOK BALANCE	TRANSACTIONS
6/30/82	469 674.56	-0-	
7/30/82	235 557.19	<234 419.89>	7/30 CHP D/D <225 978.13>
			8/2 WIRE TFR 200 000.00
8/31/82	145 046.15	-0-	
9/30/82	425 970.97	<721 296.64>	9/30 CHP D/D <721 296.64>
			10/4 UST CK 524 900.15
10/29/82	1 491 977.73	<1 359 687.46>	10/29 CHP D/D <1 572 024.41>
			11/1 DEP 152 527.29
			11/1 UST CK 1 126 120.17
11/30/82	8 542 628.10	<6 059 956.20>	11/30 CHP D/D <6 059 956.20>
			12/01 DEP 123 932.89
			12/01 UST CK 5 936 023.31
12/31/82	1 260 000.00	-0-	
1/31/83	295 806.74	<704 193.26>	1/31 CHP #1759 <1 000 000.00>
			2/01 DEP 31 638.59
			2/01 UST CK 678 475.17
2/28/83	453 037.47	<496 962.53>	2/28 CHP #2187 <950 000.00>
			3/01 DEP 115 650.54
			3/01 UST CK 593 671.20
3/31/83	288 480.17	-0-	"DEPOSITS IN TRANSIT" 430 194.90
4/29/83	563 751.12	-0-	"DEPOSITS IN TRANSIT" 110 566.00
5/31/83	397 077.47	<394 785.08>	5/31 COM NATL #1792 <394 785.08>
			6/1 DEP 107 122.70
			6/1 UST CK 287 662.38
6/30/83	591 205.17	<1 410 400.80>	6/30 COM NATL #2313 <749 532.62>
			6/30 MNY TFR <236 954.00>
			7/01 DEP 1 232 843.50

RECONCILIATIONS
COMMONWEALTH NATIONAL BANK
HARRISBURG, PA

p2 of 3

DATE	BANK BALANCE	BOOK BALANCE	TRANSACTIONS	
7/29/83	150 401.79	< 698 803.63>	7/29 CHP D/D	< 689 803.63 >
			8/1 UST CK	526 896.01
8/31/83	349 816.86	< 748 161.99>	8/31 CHP D/D	< 741 161.99>
			9/1 UST CK	485 121.63
				263 927.36
9/30/83	455 165.30	< 750 000.00>	9/30 CHP D/D	<750 000.00>
			10/03 DEP	755 263.31
10/31/83	470 308.77	< 518 870.18>	10/31 CHP D/D	< 987 124.86>
			11/01 DEP	523 866.00
11/30/83	104 256.00	< 23 108.52>	11/30 CHP D/D	< 126 629.91>
			12/01 DEP	140 288.68
12/30/83	478 688.10	< 247 617.99>	12/29 CHP D/D	< 441 448.18>
			1/03 DEP	568 245.37
1/31/84	249 419.29	< 9 724 99>	1/31 WIRE TFR	< 257 174.08>
			2/01 DEP	18 601.11
2/29/84	50 592.59	< 31 728.55>	2/29 WIRE TFR	< 81 122.61>
			3/01 DEP	413 245.41
3/30/84	167 192.04	< 44 397.64>	3/30 WIRE TFR	< 207 659.41>
			4/02 DEP	381 493.00
4/30/84	153 132.35	43 350.35		

RECONCILIATIONS
COMMONWEALTH NATIONAL BANK p3of3
HARRISBURG, PA

DATE	BANK BAL	BOOK BAL	TRANSACTIONS
1/30/81	74 406.81	<24 570.79>	1/30 CHP <37000.00>
			2/02 DEP 329466.67
2/28/81	554 958.25	10 685.35	2/27 CHP <185000>
3/31/81	138 560.83	<14 360.62>	3/31 CHP CK <153000.00>
			4/01 DEP 211,795.12
4/30/81	243 083.86	<14 847.59>	4/30 CHP <156000>
			5/01 DEP 159 983
5/30/81	147476.50	<59384.95>	5/29 CHP <207100>
			6/01 DEP 174387.78
6/30/81	352 388.66	<59 425.34>	6/30 CHP# 1531 <319000>
			7/01 DEP 257196.97
7/31/81	109 133.18	<84600.82>	7/31 CHP 1552 <83000>
			8/01 DEP 114862.13
8/31/81	479 735.08	<84532.92>	8/31 CHP# 1574 <494000>
			9/01 DEP 154307.72
9/30/81	177605.08	<24505.92>	9/30 CHP CK <202000>
			10/1 DEP 135810.66
10/30/81	194909.28	<24 403.66>	10/30 CHP <132000>
			11/2 DEP 264209.73
11/30/81	318 946.67	<34 993.33>	11/30 CHP <177000>
			12/1 259 718.20
12/31/81	432 826.12	826.12	12/31 275 000
1/29/82	516 940.70	321 990.70	
2/26/82	222 428.51	<34431.49>	
3/31/82	639 217.68	<34 074.05>	
4/30/82	307 653.19	<34 232.51>	

Mr. **Morrison**. One of the lines along this direction, the Bank of America has said that you were carrying a $75-million average overdraft on their zero balance account in December 1983, which is a whole year beyond this period.

Does that kind of an overdraft fit with your conception of the system that you've described as the new system?

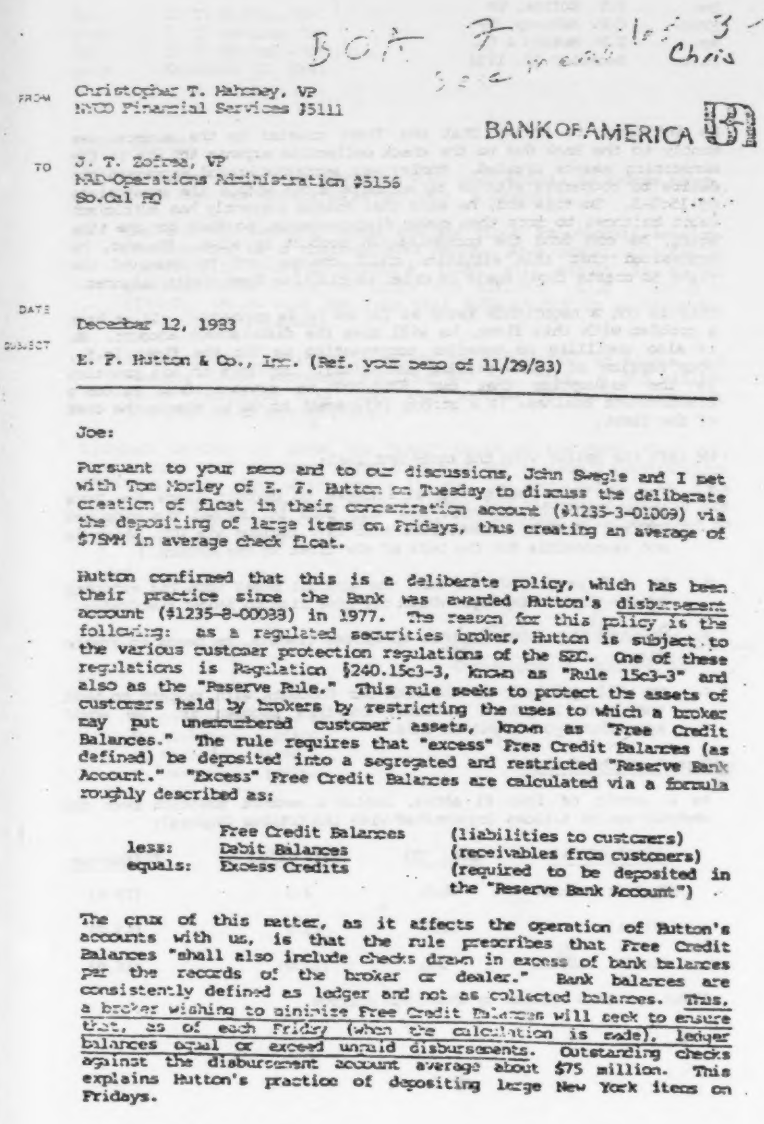
Mr. **Morley**. Well, I don't know what document you are referring to, but Bank of America is the bank that we draw our customer zero balance check. The bank will charge our account the day the check is cleared, but because they are out on the west coast, they are unable to tell us the same day the check clears how much—what is the dollar value of the check clearing. So, they charge our account today, and if we have left, then, on balance $50 million, estimating the check clearing to be $50 million, and it comes out to be something higher than that, then the result will be a negative available balance on the books of the Bank of America and we, with the Bank of America's approval, wire money in to make up for that deficiency for that 1 day. So, we are always 1 day behind them on the check clearing because, basically, they cannot tell us today what the check clearing is.

A true zero balance account would be, the bank would call us at a certain point in time, early enough for us to execute a money wire transfer to pay for all the check clearing on the day they did clear. But when you have this 1-day lag between the notification of the value of the check clearing and the actual movement of money to support that check clearing, it generates a situation where you have high balances and low balances. But where you have work with the Bank of America on a yearly basis, we get an analysis from Bank of America that we work on a global basis, and each year we balance up with them relative to the amount of money that we owe them for our check clearing and for any other service charge that we have.

Mr. **Morrison**. Mr. Chairman, I'll ask that this document of December 1983 be entered into the record.

Mr. **Hughes**. Without objection.

[The document referred to follows:]



BofA File 3 – Chris
see memo

FROM Christopher T. Mahoney, VP
NYCO Financial Services #5111

BANK OF AMERICA

TO J. T. Zofrea, VP
NAD-Operations Administration #5156
So.Cal HQ

DATE December 12, 1983

SUBJECT E. F. Hutton & Co., Inc. (Ref. your memo of 11/29/83)

Joe:

Pursuant to your memo and to our discussions, John Swegle and I met with Tom Morley of E. F. Hutton on Tuesday to discuss the deliberate creation of float in their concentration account (#1235-3-01009) via the depositing of large items on Fridays, thus creating an average of $75MM in average check float.

Hutton confirmed that this is a deliberate policy, which has been their practice since the Bank was awarded Hutton's disbursement account (#1235-8-00038) in 1977. The reason for this policy is the following: as a regulated securities broker, Hutton is subject to the various customer protection regulations of the SEC. One of these regulations is Regulation §240.15c3-3, known as "Rule 15c3-3" and also as the "Reserve Rule." This rule seeks to protect the assets of customers held by brokers by restricting the uses to which a broker may put unencumbered customer assets, known as "Free Credit Balances." The rule requires that "excess" Free Credit Balances (as defined) be deposited into a segregated and restricted "Reserve Bank Account." "Excess" Free Credit Balances are calculated via a formula roughly described as:

	Free Credit Balances	(liabilities to customers)
less:	Debit Balances	(receivables from customers)
equals:	Excess Credits	(required to be deposited in the "Reserve Bank Account")

The crux of this matter, as it affects the operation of Hutton's accounts with us, is that the rule prescribes that Free Credit Balances "shall also include checks drawn in excess of bank balances per the records of the broker or dealer." Bank balances are consistently defined as ledger and not as collected balances. Thus, a broker wishing to minimize Free Credit Balances will seek to ensure that, as of each Friday (when the calculation is made), ledger balances equal or exceed unpaid disbursements. Outstanding checks against the disbursement account average about $75 million. This explains Hutton's practice of depositing large New York items on Fridays.

To: J.T. Zofrea, VP
From: C.T. Mahoney, VP
Re: E.F. Hutton & Co.
Date: December 12, 1983

We indicated to Morley that the float created in the account was costly to the Bank due to the check collection expense and due to the nonearning assets created. Morley was sympathetic and expressed his desire to cooperate with us to minimize float within the constraints of 15c3-3. To this end, he said that Hutton currently has sufficient debit balances to more than cover disbursements, so that for the time being, he can fund the concentration account by wire. However, he emphasized that this situation could change, and he reserved the right to create float again in order to minimize free credit balances.

This is not a negotiable issue as far as he is concerned. If we have a problem with this float, he will move the disbursement account. He is also unwilling to consider compensating us for the float (c.f., your mention of a new pricing mechanism). Implicit in his position is the assumption that our $700,000 in revenue from Hutton's disbursement business is a strong inducement to us to absorb the cost of the float.

We left the matter with the agreement that:

1. For the time being, he will cease to deposit large New York items into the account, and will fund it instead via wire and DTC's. (Hutton concentrates from five regions via DTC, which is not responsible for the bulk of the float in the account.)

2. We will permit him to fund the account based upon his estimate of the day's clearings, which may give rise to ledger overdrafts.

3. He will inform us if, due to excess credits, he needs to create float.

4. We will get back to him with our thoughts with respect to what the best long-term solution to this problem is. We would appreciate your input on this.

Impact of the Change

As a result of item #1 above, Hutton's account position over the weekend was as follows (contrasted with the October figures):

($000,000's)	Oct. '83	12/9-11/83	Difference
Ledger Balance	86.0	7.0	(79.0)
Float	81.0	18.0	(63.0)
Avail. Balance	5.0	(11.0)	(16.0)

Float was thus reduced by about $60 million.

To: J. T. Zofrea, VP
From: C. T. Mahoney, VP
Re: E. F. Hutton & Co., Inc.
Date: December 12, 1983

Other Issues:

Although we are happy to cooperate with your efforts to reduce float, you should know how this will affect us as a result:

1. The NIS-500 Building Block assigns float for deposit earnings calculations on a month-delayed basis. As a result, our having successfully reduced Hutton's float will result in an OD position this month of about $70 million: $7.0 - $81.0 = ($74.0), which will cost our unit $500-600,000 in earnings for the month of December.
2. Building Block assigns 4% equity to each dollar of assets, and assigns 12.5% earnings to this equity. Thus, a $60 million asset reduction will cost our section 50 basis points or $300,000 on an annual basis.

Although neither of these are "real" costs to the Bank, they will have a very real and very major impact on our section's profitability ($800-900,000), for which we will not be compensated. In this context, you may have seen that Citibank has eliminated 100% of its float with the stroke of a pen. (See the enclosed article.) Are we considering this idea?

Chris Mahoney
Christopher T. Mahoney, VP

CTM:ech
cc: J. L. Swegle, VP - #5111
H. Mickelson - #5100
H. Warneke - #5196
M. Marowsky - #5616

AMERICAN BANKER
11/2/83

Citicorp to Remove Float from End-of-Year Reports

By ROBERT H. GARSSON

NEW YORK — Float has always been something of a mixed blessing for the American banking community — beloved by those who value asset growth and despised by the guardians of a bank's financial ratios.

Now Citicorp, apparently deciding that float is nothing more than clutter on its balance sheet, plans to eliminate deposit float from its end-of-the-year financial reports. Thus, with a stroke of the pen, the bank holding company will diminish its asset size — by an unknown, though apparently small amount — and improve its return on assets, leverage, and capital position.

And while Citicorp is apparently the first major banking company to take this step, others are considering it. Indeed, the banking giant's decision could lend credibility to the idea of wiping a bank's balance sheet clean of float.

"I would think that excitement about it would be epidemic once people realize major New York banks are doing it," said Stanley E. "Ned" Miltko, the director of the Bank Administration Institute's operations and automation group.

Last year, Mr. Miltko oversaw a research project on float that was conducted for the Rolling Meadows, Ill., institute by Littlewood, Shain & Co. of Wayne, Pa. The resulting report, entitled "An Analyis of Float in the Commercial Banking Industry," pointed out that float could be eliminated from a bank's balance sheet but avoided making a judgment on whether banks should take that step.

Among those interested in the idea is Manufacturers Hanover Trust Co., which has organized a task force to study the question. Because of its large correspondent business, the bank would be expected to be among those most dramatically affected by such a change.

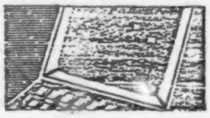
However, Peter J. Tobin, senior vice president and controller of Manufacturers Hanover, said the impact of such a change could prove modest.

"I would guess that it would knock off no more than $2 billion," he said, reducing the bank's asset base to about $36 billion.

In the most recent quarter, that would have added two basis points to Manufactuers Hanover's return on assets, raising it to 0.58%, or 58 cents for each $100 of assets.

Mr. Tobin notes that there is a precedent for the move — float is netted against deposits for the purpose of calculating a bank's reserve requirement — but he believes the issue may involve some difficult questions.

"First, we want to make sure first that we have a firm legal basis for it," he said. "Once that is settled, there is a problem of determining how to identify that float which should be netted out."



However, the BAI's float study noted a second precedent, which involves identifying deposit float on a routine basis: "Banks also deduct float from their customer's ledger balances when computing the net demand balances on which the bank grants an earnings allowance."

While float is defined in various ways, the item under discussion is deposit float, the float created when checks are deposited and reflected on a bank's balance sheet while still in the process of collection.

These cash items in the process of collection — or CIPC, as they are known in the industry's jargon — have traditionally been classified as assets, the BAI noted in its study, on the grounds that they are funds "that will be collected in the short term, in a manner akin to accounts receivable."

On the liability side, it has traditionally been assumed that the depositor also has a claim against the funds, albeit one that cannot be exercised until the funds are collected through the clearing system.

The accounting practice "probably became generally accepted more by default than by a reasoned determination," said Citicorp Financial Control, a Citicorp unit, in a position paper it recently circulated among bank accounting officers.

'Distortive Effect' on Ratios

"It has artificially inflated total assets and total liabilities for checks for which the bank had not yet received good funds," continues the paper, adding: "This is of particular concern today because of the distortive effect on key financial ratios, such as return on assets and leverage."

While Citicorp's accounting officers declined to comment directly on the position paper, one knowledgeable Citicorp source said the impact of the change "will be de minimous."

"It will affect less than 1% of total assets," said the source, who asked not to be identified. Return on assets, a widely followed financial ratio, would be improved by no more than a few basis points, he added.

Michael Moran, a senior partner in the New York banking group at Peat Marwick Mitchell & Co., a Big Eight accounting firm that audits financial statements for a number of large banks, including Citibank, agreed that the impact will be small.

"For a bank with a capital ratio of 4.7% on 100 billion in assets, a drop of $5 billion in float gets them an extra 26 basis points," he noted.

There are probably no accounting rules to stand in the way of implementing Citicorp's proposal, Mr. Moran said, although it may prove difficult routinely to identify float that can be eliminated from the balance sheet.

"But if it can be [identified] and audited, then there is nothing in the accounting literature to prevent it," he said.

Citicorp's proposal, as stated in its position paper, is to report deposited checks on a collection basis.

"Under this approach, a deposit transaction would not be reflected on a bank's balance sheet until the checks have been collected (or until funds are made available to the customer, if prior to collection)," the holding company said in a report.

The Citicorp position paper discusses the legal, regulatory, and accounting issues in turn, dismissing the notion that there might be any barriers to netting float off the balance sheet.

"It's about as clean an accounting issue as you could imagine," said the Citicorp officer.

"From a legal point of view, a bank's obligation to pay out funds at its customer's direction arises from the receipt of deposited funds," Citicorp notes in its paper.

"However, receipt of a check does not itself constitute receipt of funds — and therefore does not give rise to a legal obligation — since a check, unless certified, is simply a request for payment.

"Similarly, the corresponding item in process of collection does not yet represent good funds, and a bank does not yet have legal control over funds because the item may not be honored."

Thus, Citicorp concludes, deposited checks that are uncollected do not represent a legal obligation.

On the regulatory side, Citicorp notes that float is already netted against deposits for the calculation of required reserves.

"In this way, double counting is avoided since the bank on which the check is drawn — which continues to have use of the funds — continues to maintain required reserves," the Citicorp paper continues.

The reserve calculation would thus be unaffected by the proposed change in the treatment of deposit float for financial accounting.

"With respect to regulatory reporting, uncollected deposits are included in the balance sheet for call report purposes, even though the same arguments supporting the change in financial reporting to shareholders are also applicable to regulatory reporting," the paper notes.

"In any case, there is no reason the regulatory treatment cannot differ from the financial reporting treatment," it adds.

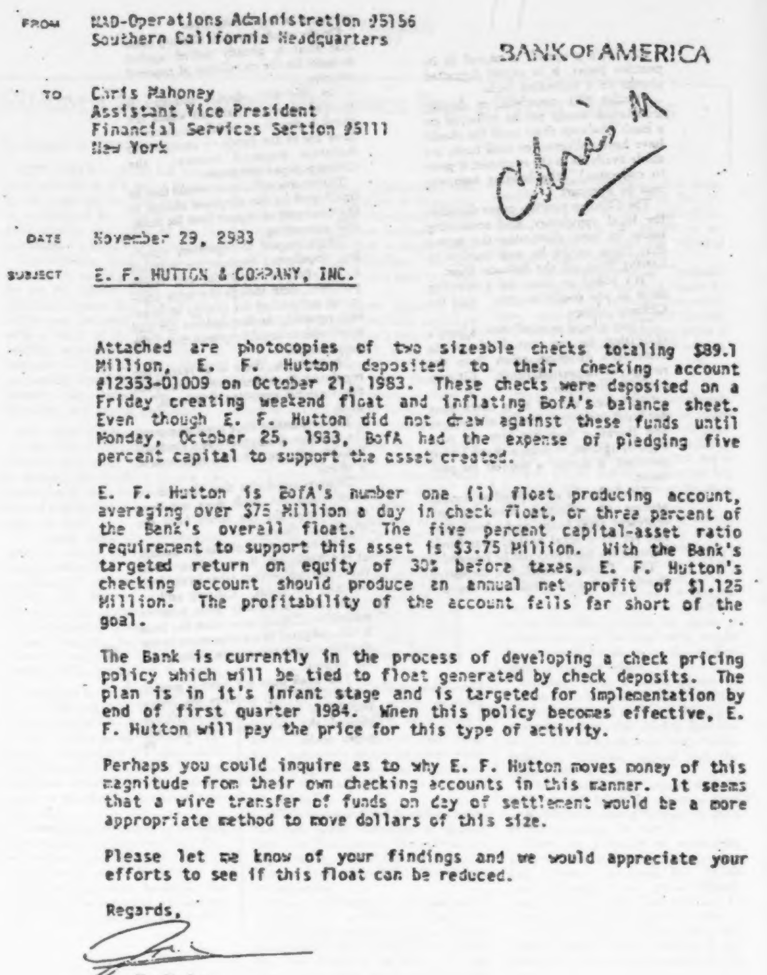
The accounting issue revolves around the question of whether a real asset and liability exist prior to the collection of a check.

Citicorp concludes that there is no asset, since the bank does not have control over the the funds until the check has cleared.

"The bank cannot obtain the benefit of the funds, i.e., it can neither invest the funds nor prevent other banks from utilizing the funds," Citicorp adds.

Nor does a liability exist prior to collection, Citicorp says, since the bank is not obligated to transfer assets to the depositor upon acceptance of the check for deposit.

"The bank does not have a present responsibility that requires the future transfer of assets until the check has cleared the collection process," the paper adds.



FROM NAD-Operations Administration #5156
Southern California Headquarters

BANK OF AMERICA

TO Chris Mahoney
Assistant Vice President
Financial Services Section #5111
New York

Chris M

DATE November 29, 1983

SUBJECT E. F. HUTTON & COMPANY, INC.

Attached are photocopies of two sizeable checks totaling $89.1 Million, E. F. Hutton deposited to their checking account #12353-01009 on October 21, 1983. These checks were deposited on a Friday creating weekend float and inflating BofA's balance sheet. Even though E. F. Hutton did not draw against these funds until Monday, October 25, 1983, BofA had the expense of pledging five percent capital to support the asset created.

E. F. Hutton is BofA's number one (1) float producing account, averaging over $75 Million a day in check float, or three percent of the Bank's overall float. The five percent capital-asset ratio requirement to support this asset is $3.75 Million. With the Bank's targeted return on equity of 30% before taxes, E. F. Hutton's checking account should produce an annual net profit of $1.125 Million. The profitability of the account falls far short of the goal.

The Bank is currently in the process of developing a check pricing policy which will be tied to float generated by check deposits. The plan is in it's infant stage and is targeted for implementation by end of first quarter 1984. When this policy becomes effective, E. F. Hutton will pay the price for this type of activity.

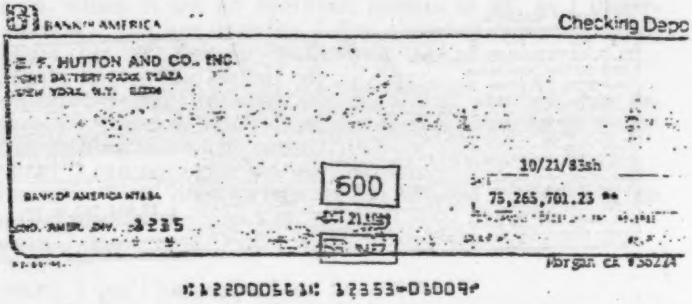
Perhaps you could inquire as to why E. F. Hutton moves money of this magnitude from their own checking accounts in this manner. It seems that a wire transfer of funds on day of settlement would be a more appropriate method to move dollars of this size.

Please let me know of your findings and we would appreciate your efforts to see if this float can be reduced.

Regards,

J. T. Zofrea
Vice President
LA 82677

JTZ/tjb
Attachments
cc: ✓ John Swegle, #5111
Howard Nickelson, #5100
Herb Warneke, #5196
H. Marowsky, #5616



BANK of AMERICA

Checking Depo

E. F. HUTTON AND CO., INC.
ONE BATTERY PARK PLAZA
NEW YORK, N.Y.

10/21/83sh

600

OCT 21 1983

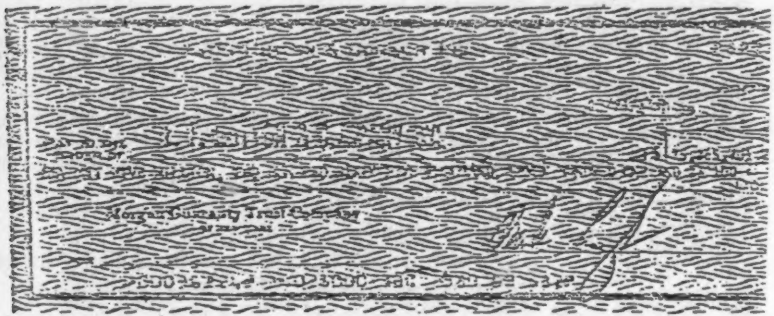
75,265,701.23 **

BANK OF AMERICA NT&SA

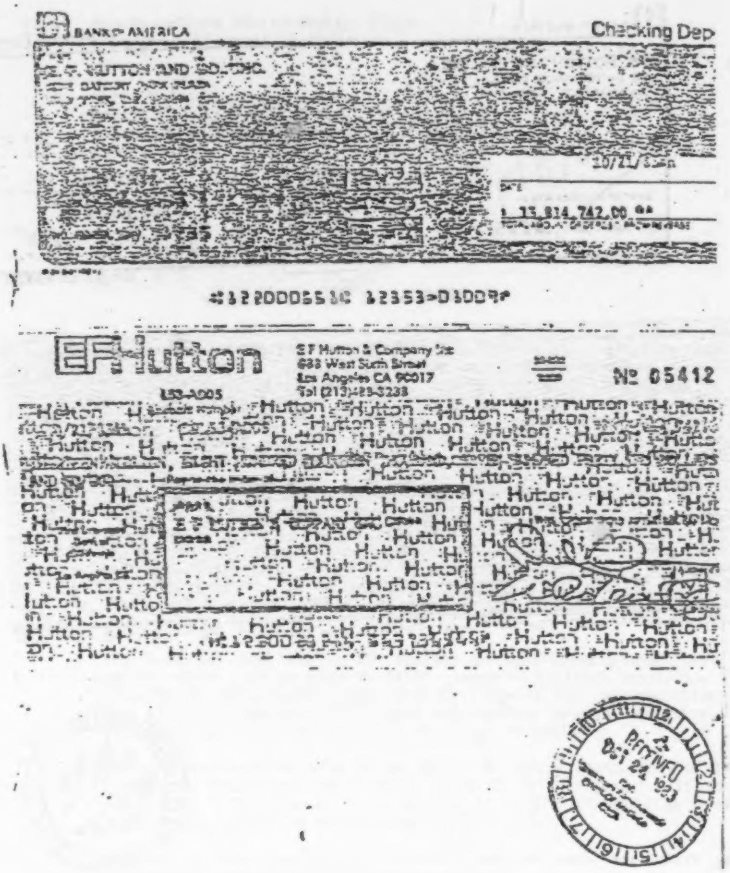
CO. AMER. DIV. 3235

Morgan ck #50224

⑆122000661⑆ 12353-01009⑈



Morgan Guaranty Trust Company



BANK of AMERICA

Checking Dep

E. F. HUTTON AND CO., INC.

10/21/

$ 13,814,742.00

⑆122000661⑆ 12353⑈01009⑈

E F Hutton & Company Inc
888 West Sixth Street
Los Angeles CA 90017
Tel (213) 483-3233

133-A005

№ 05412

RECEIVED
OCT 24 1983

Mr. **Morrison**. I assume that the new system which you are now operating on, which is not an overdraft system at all, as I understand it, except if you are drawing 1 day ahead of expected availability. Would that be a fair way to describe it?

Mr. **Morley**. That would be fair, sir.

Mr. **Morrison**. Is that industry standard that you are now behaving on or are you now being disadvantaged because most people are doing something more aggressive?

Mr. **Morley**. I can only give you my opinion.

Mr. **Morrison**. Well, does anyone at the witness table know the answer to that question?

Mr. **Fomon**. I don't.

Mr. **Lynch**. No.

Mr. **Morley**. I don't know, but——

Mr. **Morrison**. No one looked into that when you were agreeing to the consent decree and agreeing to what you would do in the future, as to whether or not you would be disadvantaged in the future by what was standard practice in the industry?

Mr. **Lynch**. I think we recognized we would be disadvantaged until we could reach a new agreement with each of the banks, that it was a very restrictive system and probably more restrictive than those of other firms.

Mr. **Morrison**. So you don't know?

Mr. **Morley**. I don't know, sir.

Mr. **Morrison**. But under the current situation you are governed by the agreement that the banks have made?

Mr. **Morley**. That is correct.

Mr. **Morrison**. You can't tell us whether we've got a problem out there with everybody else doing what you were doing?

Mr. **Morley**. I have no idea, sir.

Mr. **Morrison**. Thank you, Mr. Chairman.

Mr. **Hughes**. I wonder if we can get back, take you back to the Genesee and United Penn episodes, back in December 1981. At that time Genesee Bank, a bank I think bounced 21—well, bounced one check of about $8 million and the total overdrafts were about $21 million. In the same timeframe, United Penn Bank also demanded checks to cover something like $19 additional million in overdrafts for $39 million to December 1981.

Mr. Fomon, were you made aware of those episodes in 1981?

Mr. **Fomon**. Yes.

Mr. **Hughes**. And when that type of an episode takes place, who is notified in the company?

Mr. **Fomon**. Actually, I'm hazy on the dates. I guess I was notified February 1982, not the day that it happened.

Mr. **Hughes**. Did anybody in upper management have knowledge of those overdrafts when they occurred?

Mr. **Fomon**. You mean when the checks bounced?

Mr. **Hughes**. Yes.

Mr. **Fomon**. Yes.

Mr. **Hughes**. Did anybody take a look at the reason for overdrawing the account by a total of $39 million between those two banks?

Mr. **Fomon**. Mr. Epstein is senior management. I am sure that he looked at it.

Mr. **Hughes**. You see, my concern is that if you just looked at those two transactions, you had to understand that there were literally dozens and dozens of banks involved, that it was excess drawdowns on bogus funds. And what I am puzzled about is how anybody in top management could be unaware of the nature and extent of those types of overdrafts.

Mr. **Fomon**. Well, first of all, as I understand it, those were not overdrafts as a result of excessive drawdowns. Those were overdrafts that resulted from the multiple transfers. And that chain broke of its own weight.

Mr. **Hughes**. Wasn't it a combination of both? Wasn't it a matter of major overdrafts as well as of chaining?

Mr. **Fomon**. At that time we had no reason to believe that there were excessive drawdowns involved. All that we could see was the amount of transfers.

Mr. **Hughes**. Well, when you bounce $39 million worth of checks, isn't it something to become concerned about? That doesn't happen every day, does it?

Mr. **Fomon**. Well, Norman Epstein is head of the operations department. He is an executive vice president. He is a member of the board of directors. He is the person, the highest ranking person most qualified to look into the situation.

Mr. **Hughes**. I'll tell you another thing that puzzles me, and we'll ask Mr. Epstein about that. But another thing that puzzles me is that in order to orchestrate the type of cover that one has to do to satisfy these banks on a daily basis requires a lot of telephone calls and a lot of check writing. As I understand it, each of the branch banks had the authority to cover a deficiency overdraft in their account by writing a check on the zero balance account. And when the drawdown occurred, I gather it occurred at the regional office, there was somebody in operations at the regional office that drew down that money on a daily basis and it was the responsibility of the regional office to get that money to your major accounts where funds were concentrated, in New York or Los Angeles.

Mr. **Fomon**. Right.

Mr. **Hughes**. Am I correct in that?

Mr. **Fomon**. Yes.

Mr. **Hughes**. So that every day some determination would have to be made by the branch manager and the others, I presume, as to how much was needed to drawdown out of a zero balance to cover overdrafts. Apparently there were, you know, dozens of overdrafts every day, so somebody had to be looking at the ledger of each of the banks because you didn't know unless you checked with the bank, I presume, to see what had cleared before 3 o'clock in a given day.

Who was overseeing that, anybody at all, or did it just happen?

Mr. **Fomon**. That is what was wrong with our system, as far as I can tell, no one was charged.

Mr. **Hughes**. How did they learn to do that? I mean, is that something that was just spontaneous, like——

Mr. **Fomon**. Word of mouth. They taught themselves how to do it. I assume that one branch manager figured out how to do this and confided in another branch manager about multiple transfers in one of his branches, and it just grew.

Mr. Hughes. Were there any training sessions where this technique was talked about?

Mr. Fomon. That is what Griffin Bell is going to find out.

Mr. Hughes. Well, let me, if I might, share a memorandum with you that originated in one of your branches. And I ask if you are aware of the memorandum. It is dated March 12 of 1982, and it goes from—it is from Steve Bralove, who, I understand, is a branch manager here in the D.C. area, to Perry Bacon, who is also a branch manager in the D.C. area.

Are you familiar with that particular memorandum?

Mr. Fomon. Yes, I am.

Mr. Hughes. Mr. Morley, are you familiar with that particular memorandum?

Mr. Morley. I have seen that, sir.

Mr. Hughes. You've seen it?

Mr. Morley. I have seen it in the course of the day.

Mr. Hughes. If I might, let me admit it for the record without objection.

[The information follows:]

[COPY]

PERRY BACON

STEVE BRALOVE

3/12/82

INSTITUTIONAL AND BANKING RELATIONSHIPS

About two weeks ago we received word through the trust department of First American Bank that they had been directed not to do any more securities business with E.F. Hutton. We were informed that Hutton had substantial overdrafts againt the bank which had resulted in large losses. Since we have always enjoyed a good business relationship with First American, I was very surprised at this news.

Through Rick Frisbie's efforts, we were able to meet with the Chairman of the board and the President of the bank to discuss the problem. They presented us with the yearly bank analysis which indicated that the C16 office had an average daily balance of over $27,000 throughout the course of the year. C16 was not the problem. Your office, C18, had established an account in June which carried constant debit balances throughout 1981. In fact the debits in each of the last four months of 1981 exceeded $2,000,000.00.

At that point I called in Tom Morley. He has been involved in numerous discussions with First American in an effort to reestablish our credibility and reputation. In the meantime, our institutional relationship has been severely strained and our banking relationship basically destroyed. Additionally, First American has been in contact with all of the area banks with which we do business, and all of the banks are now holding our checks.

I have spent the last couple of weeks trying to repair the damage created by your efforts to make excessive interest profits for your office. Of course, we are all concerned with maximizing profits in our offices, but not at the expense of our business reputation or future profitability. Your excessive overdrafting shows a blatant disregard for the consequences of your actions.

Since your office does not do any institutional business, you are not concerned with this market. However, these relationships have a substantial impact on C16. Three Founders Club producers, Lon Smith, Rick Frisbie, and Leo Sullivan, are significantly affected by the relationships which you have so casually damaged. These relationships were established long before either of us became associated with Hutton.

When I spoke to you a couple of months ago and indicated that excessive overdrafting of the banks would jeopardize

Hutton's banking and institutional relationships I found your attitude completely indifferent to Hutton's reputation in this city. Hutton is viewed as one entity by the Washington business community. No distinction is made between individual offices. Our office could suffer considerable loss of revenue in institutional commission business, and our ability to generate interest income from the float has been dramatically reduced. It is impossible to measure the damage you have done to the reputation and credibility of E.F. Hutton and our office.

/s/ Steve

cc: John Latshaw

Mr. **Hughes**. There are actually two memos involved, first the memo from Mr. Bralove to Mr. Bacon. Mr. Bralove says that the First American Bank's Trust Department has been instructed to not do any more securities business with E.F. Hutton: "We are informed that Hutton has substantial overdrafts against the bank which resulted in large losses."

Mr. Bralove says that he learned that Mr. Bacon's office was the one creating the substantial overdrafts and that Hutton's institutional relationship had been severely strained "and our banking relationship basically was destroyed additionally. First American has been in contact with all the area banks with which we do business, and all the banks are now holding our checks."

[The information follows:]

Resp. Exhibit 174
6-28-85 (late filing)
W.N.

#11

EFHutton
INTER-OFFICE MEMORANDUM

TO : Steve Bralove

FROM : Perry H. Bacon

DATE : April 23, 1982

SUBJECT : Your Memo - Banking Activities

Our banking activities during the last six months have been no different than our banking activities off and on for the last five years. Additionally, I believe those activities are encouraged by the firm and are in fact identical to what the firm practices on a national basis. Specifically, we will from time to time draw down not only deposits plus anticipated deposits, but also bogus deposits. One day prior to that incremental drawdown arriving at our bank, we may need to cover with a New York (Chemical, U.S. Trust) check. As long as the local bank honors that check with same day availability, the firm profits at both the branch and the national level. We profit at the branch level by creating a surplus in general ledger revenues which are credited at the broker call rate. We profit at the national level for two reasons: 1) Because New York is doing the same thing with the U.S. Trust check by reacting to our bank wire and floating checks based on those deposits which deposits may not really exist. 2) Because those bogus deposits create a reduction in our net capital ratio requirement which allows the firm to deploy capital elsewhere. Furthermore, we (as a firm) learned to use the float because it is exactly what the banks do to us (see enclosed article). I know of at least a dozen managers at E. F. Hutton - managers who along with Bill Sullivan and Tom Morley taught me the system - who do precisely the same thing. Presumably, any manager who was willing to take the time to learn the system would want to use the system.

The obvious drawback to the system is that it can cost the bank money. If the bank honors a New York deposit check with same day availability and subsequently have those funds withdrawn by a New York drawdown check before they get FED usage of the funds, they have a net debit. On the other hand, the bank is not quite the defenseless amoeba that your memo suggests. FIRST, the system only exists because, peculiarly, our mammoth federal banking system is more hand processed than automated - NB - a system which the banks well know how to use as the enclosed article discusses. SECOND, the system we use does not happen the day we open an account. We spend months working up to larger drawdowns leaving the bank surplus deposits, and I do not recall any bank offering to send us their earnings on those deposits.

NB - There is not much difference between what we do and when a bank tells you not to write checks on your out of state deposit for 10 days, clears that check through the FED in 2 days and enjoys the float for 8 days. Essentially, the bank has created a net debit against you in the form of 8 day nonusable funds. By the way, Tom Morley believes that within 2-3 years the entire system will be automated and all domestic checks will clear in one day. Therefore, as Tom stated in our New York BOM meeting, the time to take advantage of the system is now. (See second enclosed article.)

Steve Bralove
Page 2
April 23, 1982

THIRD, all banks either now know or eventually figure out our system. When they do, they simply cease giving same day availability, and often will not court regular checks as collected funds. In fact, contrary to your implication that all banks are now holding your checks, NBW (a bank with whom we have never dealt) had been doing that to you months before this issue arose. FOURTH, if a bank is slow to move on #3 above, documents a net loss and asks us for same, we will probably give it to them. Our objective is not to steal money from the banks. Whatever the bank may have lost, we have enjoyed a greater profit due to the spread float.* I am aware of four branches that have had to write checks within the last six months for just the reasons listedabove. On the other hand, many banks accept their losses as a cost of doing business and never ask for the money.

This last point leads to some of the specific remarks in your memo. FIRST, when you called a few months ago and asked if I was aware that due to our overdrafts, 1st American was giving you trouble with your secondary account there, you will recall that I replied that I was not aware, and I replied that I would not do any more overdrafting at that bank. If I sounded unconcerned, it was because your terse interrogatory was limited to your secondary bank account. The first time I heard about an institutional problem was from Ernie some weeks ago. Your conclusion that my attitude to Hutton's reputation in the city is "indifferent" is ridiculous. I confess to an emotion somewhere between indifference and astonishment at your suggestion that the solution to your secondary account problem was to call and offer money to a bank that had not, and to this date has not called me to complain, ask for money or request to discuss the issue - in fact has never called me at all. SECOND, your remark that since 1st American has contacted all of the area banks and now all banks are holding checks is not only contradicted by your knowledge that NBW had already been doing that, but would further suggest violation of any number of federal and banking statutes regarding collusion and anti-trust. THIRD, and what really troubles me, is that your constant use of terminology such as "excessive," "blatant disregard," "casually damaged" and "indifferent" is way out of line - and I think you know it. I plead guilty to simply never having considered that an institutional relationship could be jeopardized. Importantly, if our zeal with the bank has in any way impaired your ability to do business with that bank, I am genuinely sorry and would like to apologize to you and anyone else adversely effected. However, your sweeping implication that such an isolated incident immeasurably damages our reputation and ability to transact

*Ex. - the average balance that we earned on during the months to which you refer was significantly greater than the 2 million figure that the bank stated.

business seems highly specious and your manner in phrasing that suggestion is regrettable.

When the four of us joined E. F. Hutton five years ago, the prime motivation was not so we could move into an antagonistic environment. That environment happened because 3-4 good and loyal Hutton brokers felt we were being given something that they had earned. We have often worked to ameliorate that situation by offering joint business projects as well as combined social functions. As you are well aware, in years gone by, every A.E. in your office has been invited to my personal Christmas party. An admittedly biased opinion of good team spirit might also include. . . referring three brokers to you that you have hired . . . when one of those brokers approached me about moving to our new quarters, telling him what a good office you had molded and advising him to stick with you and appraising you of same.

An equally biased opinion of what teamwork is not . . . after hiring 20 brokers from DWR, including 4 in the preceeding 100 days, and one A.E. in financial difficulty leaving to take advantage of their publicized open checkbook . . . teamwork is neither condoning nor advising two A.E.'s in your office to key off of that incident and call two brokers in my office and tell them it is okay to leave my office because they can always go to your office or Bethesda. Or does Dan Quigley enjoy such a leadership capacity in the region that he would take it on his own authority to call Jeanie Henry to talk about "her career?"

I have some familiarity with how much work goes into recruiting and cannot imagine anything more insidious than taking advantage of uncertain times by purposefully proselytizing within a firm. Therefore, I would ordinarily have overlooked the last, assumed it was the result of lingering animosity outside of your leadership, and not mentioned it. Unfortunately, coupled with the tone of your memo, it is very coincidental.

Steve, from 1977-1980, I think that we enjoyed a close personal friendship as well as a highly professional relationship, both of which saved Hutton in every sense. In the past year, you have interpreted some of our ideas (ERISA office, Mulcahey, bank overdrafting) in an inexplicable and highly personalized manner. Specifically, on the bank:

1. Ernie and I discussed our banking activities on a dozen different occasions, and it simply never occured to either of us that we might be jeopardizing an institutional relationship.

2. Our activities are generally consistent with, and encouraged by the firm.

3. Our banking activities are generally consistent with what the banks do to their clients.

4. To the extent we did cause any damage, I am sorry, and obviously willing to help ameliorate.

I would like to rejuvenate the relationship that we previously enjoyed, and think that a meeting towards that end would be timely.

Enclosures

cc: John Latshaw
    Ernie Dippel
    Gary Irish

BUSINESS & FINANCE Thursday, March 11, 1982

ESTIMATED FLOAT TIME FOR AREA BANKS AND S&LS

a consumer were to deposit a $1,000 check drawn on a New ..k City bank; what is the maximum float time before the same nsumer can withdraw funds from that check? Also, if the same mount were deposited by a check from a local bank, what ould be the float time?

	NEW YORK CITY	LOCAL
MERICAN SECURITY	3 DAYS	1 DAY
C. NATIONAL	7 DAYS	4 TO 5 DAYS
ADISON NATIONAL	7 TO 8 DAYS PENDING A WEEKEND	3 TO 5 DAYS
ARYLAND NATIONAL BANK	4 DAYS (WORKING)	3 DAYS
JBURBAN BANK	8 DAYS (WORKING)	3 DAYS
ANDY SPRING NATIONAL	10 DAYS	5 DAYS
GGS NATIONAL BANK	10 DAYS	5 DAYS
OMEN'S NATIONAL BANK	5 DAYS	3 DAYS
ANK OF DAMASCUS	7DAYS	3 TO 4 DAYS
ANK OF VIRGINIA	5 TO 7 DAYS	3 TO 4 DAYS
ST AMERICAN BANK OF VIRGINIA	5 TO 10 DAYS	6 DAYS
UARANTY BANK AND TRUST	8 TO 10 DAYS (WORKING)	4 DAYS
NITED VIRGINIA BANK	7 DAYS	3 DAYS
RPETUAL AMERICAN S&L	10 DAYS	5 DAYS
ATIOANL PERMANENT	4 TO 7 DAYS	3 TO 4 DAYS
HEVY CHASE S & L	15 DAYS	8 DAYS
OVERNMENT SERVICES	14 DAYS	7 DAYS
OHN HANSON S & L	14 DAYS	7 DAYS
ONTINENTAL FEDERAL S & L	10 DAYS	5 DAYS
ASHINGTON-LEE S & L	14 DAYS	7 DAYS

ICE: A TELEPHONE POLL CONDUCTED AT THE WASHINGTON POST BY [illegible] ON MARCH 10

Senate Unit Threatens to Act On Banks' Holds on Checks

By Nancy L. Ross
Washington Post Staff Writer

A Senate committee warned yesterday that unless the Federal Reserve Board takes action, it will consider legislation dealing with the way many banks use customer deposits for profit while delaying customers' access to their own funds by "holding" checks.

Sen. Christopher J. Dodd (D-Conn.) made the threat at a hearing intended to publicize how individuals and small businesses are inconvenienced or harmed because they can't get their money as soon as they deposit a check, although they often are earning interest on it.

Dodd said he would introduce legislation unless the Fed agrees to carry out recommendations made in 1979 by an American Bankers Association task force. The recommendations urge that, as a minimum, the Fed write to all bank directors suggesting that they voluntarily make all their customers aware of the existence and terms of their delayed-funds-availability policies, as the "hold" is formally known.

The Federal Reserve Bank of Atlanta issued a study in January saying that 80 percent of the 125 million commercial (nongovernment) checks processed daily under the best conditions could be cleared

between one and six days, according to the Fed.)

The problem comes when a check is returned unpaid. Then it must be rerouted manually through all the banks involved in clearing it, a procedure that can take double the amount of time required to put it in for collection.

Financial institutions impose holds to protect themselves against bad checks, whether due to insufficient funds, forgery or fraud.

The most trouble involves new accounts and unusual transactions such as the sale of a home.

A telephone survey of 20 area banks and savings and loans conducted yesterday by The Washington Post shows a wide variance in maximum holds. For a $1,000 personal check written on a New York City bank and deposited to an existing account in a Washington bank, anywhere between three and 10 business days can pass before a customer gets access to the funds.

Checks written on local banks and deposited in other local banks have a hold of between one and five days. Most banks emphasized that these are maximum delays they impose and that the actual average time is considerably shorter.

Savings and loan associations require more time because they must

system. The maximum for the same out-of-town check at S&Ls ranges between seven and 15 working days. For local checks, all of the S&Ls surveyed said the longest delay is seven days.

While recognizing the legitimate need for protection, critics charge the banks with overkill. Dodd cited a 1973 study showing that banks lost $5 million a year from uncollectible checks, an amount that probably has more than doubled by now. Nevertheless, because that represents less than one percent of all checks written, he questioned why the other 99 percent of check writers should suffer.

Not only do banks impose an inconvenience on customers, they make a profit doing it by investing the funds at market rates after the check has cleared and before the funds are turned over to the owner.

Subcommittee Chairman John H. Chafee (R-R.I.) declared, "In a period of high interest rates, this practice is especially lucrative for banking institutions, and costly for the customer.

"When the hold is routinely extended, without indication of particular risk, this practice, at best, becomes a hidden cost of checking and at worst, a genuine consumer abuse."

Dodd calculated the value of the

See FLOAT, D12, Col. 5

Action Threatened on Holds

FLOAT, From D10

"float"—the amount of interest banks earn on customers' funds—at $1 billion a day. However, it is not known how much of this is profit.

Both the industry and the Federal Reserve oppose any move to set limits on the number of days banks can hold checks before releasing funds. They say not only would it be impossible to define the proper period due to vast differences in banks' experiences with the clearing process, but any maximum would become the industry standard, thus worsening the situation for many customers.

The solution, according to the Fed, lies in speeding the process of returning bad checks. It also urges increased use of electronic funds transfers, which eliminate the need for a hold.

Yet, because they also eliminate the check float for the consumer, types of instantaneous banking such as having payment automatically deducted from one's account at the point of sale is not that popular with the public.

Recognizing that holds are bad public relations and in some cases can put them at a disadvantage with their competition, banks are trying various means to remedy the situation

Mr. HUGHES. Mr. Bacon responds on April 23, 1982, and I am quoting from his communication: "Our banking activities——

Mr. FOMON. What is the date of his memo?

Mr. HUGHES. April 23, 1982, and we'll make them available to you.

He said:

> Our banking activities during the last 6 months have been no different than our banking activities, off and on, for the last 5 years.
>
> Additionally, I believe those activities are encouraged by the firm and are, in fact, identical to what the firm practices on a national level. Specifically, we will, from time to time, draw down not only deposits plus anticipated deposits but also bogus deposits. Emphasis added. I know of at least a dozen managers at E.F. Hutton, managers who, along with Bill Sullivan and Tom Morley taught me the system, who will do precisely the same thing.

Mr. Bacon adds:

> Tom Morley believes that within 2 or 3 years the entire system will be automated and all domestic checks will clear in 1 day. There, as Tom stated in our New York branch office manager's meeting, the time to take advantage of the system is now.

In other words, "Let's rip off the system before the system becomes technologically more sophisticated;" isn't that what it says? Isn't that what the memo says?

Mr. FOMON. Yes.

Mr. HUGHES. Well, Mr. Morley, that would suggest, contrary to what you've told us, that, in fact, you did have conversations with branch managers; at least that is what is implied here.

Mr. MORLEY. Sir, the conversations or the system that I would explain to the branch managers would be the approved draw——

Mr. HUGHES. You're not being candid with us.

Mr. MORLEY. I wouldn't want to say that I——

Mr. HUGHES. Would you agree that that is inconsistent with what you have told us today?

Mr. MORLEY. Yes, sir.

Mr. HUGHES. One of the things that——

Mr. FOMON. Wham.

Now, what Mr. Bacon determined—what Mr. Bacon did was not what I instructed him to do.

Mr. HUGHES. Well, Mr. Bacon, you know, very clearly, I think, suggests that he learned the system from you and Mr. Sullivan. So, either he is incorrect or else you're not being candid with us.

Mr. MORLEY. I wouldn't want to say that I——

Mr. HUGHES. Would you agree that that is inconsistent with what you have told us today?

Mr. MORLEY. Yes, sir.

Mr. HUGHES. One of the things that——

Mr. FOMON. What is interesting about that memo is, why did he write it?

We had already stopped all the illegal practices before he wrote that memo.

Mr. HUGHES. You're posing a good question, because obviously, either Mr. Bacon did not receive that communication nor did Mr. Bralove, obviously, because Mr. Bralove would have quoted that memo to Mr. Bacon, because Mr. Bacon is trying to be—he was saying to Mr. Bralove, "Don't be a Boy Scout, friend."

Isn't that what he was saying?

Mr. **Fomon**. Sure.

Mr. **Hughes**. "You know this has been standard operating procedure and sanctioned by headquarters for a long time, you know that. We picked this up at the training sessions. So don't—you don't give me this nonsense, we're making a lot of money on this. You know, who are you trying to kid?"

That's what he's saying, essentially, and it refutes very directly what you have told us here today, Mr. Morley, because if Mr. Bacon is telling the truth, then you haven't been candid with us.

When did you first learn of this memorandum, Mr. Fomon?

Mr. **Fomon**. Recently, in the last 3 months.

Mr. **Hughes**. Would you say in the last day or so?

Mr. **Fomon**. The last day?

Mr. **Hughes**. The last day.

Mr. **Fomon**. No, no. I was shown that memo a couple of months ago.

Mr. **Hughes**. Does that memo disturb you?

Mr. **Fomon**. Very much.

Mr. **Hughes**. Have you had any conversation with Mr. Bacon and Mr. Bralove about it, anybody on your staff?

Mr. **Fomon**. No, I'm going to leave that to Griffin Bell. And I'm meeting with Mr. Bell on Friday.

Mr. **Hughes**. The memo was speaking of the aggressive drawdown practices in Virginia and the District of Columbia in particular, which accounts for the high positive interest profit ratio that was compiled by the central region, I presume.

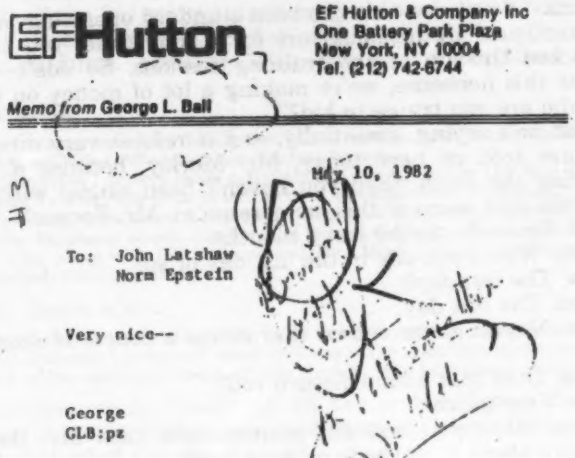
Mr. **Fomon**. I believe so. They only got up to that high number by using illegal practices.

Mr. **Hughes**. Are you familiar with the fact that the First American Bank complained to E.F. Hutton about the draw down and the overdrafts? Are you familiar with——

Mr. **Fomon**. No. I mean—but only when I read the letter. But normally, that is something that would not be called to my attention.

Mr. **Hughes**. Without objection, I am going to introduce for the record a letter from Frances G. Addison to Mr. George L. Ball. Mr. Addison is an officer, in fact chairman of the board and chief executive office of the First American Bank here in Washington, DC.

[The information follows:]



EF Hutton & Company Inc
One Battery Park Plaza
New York, NY 10004
Tel. (212) 742-6744

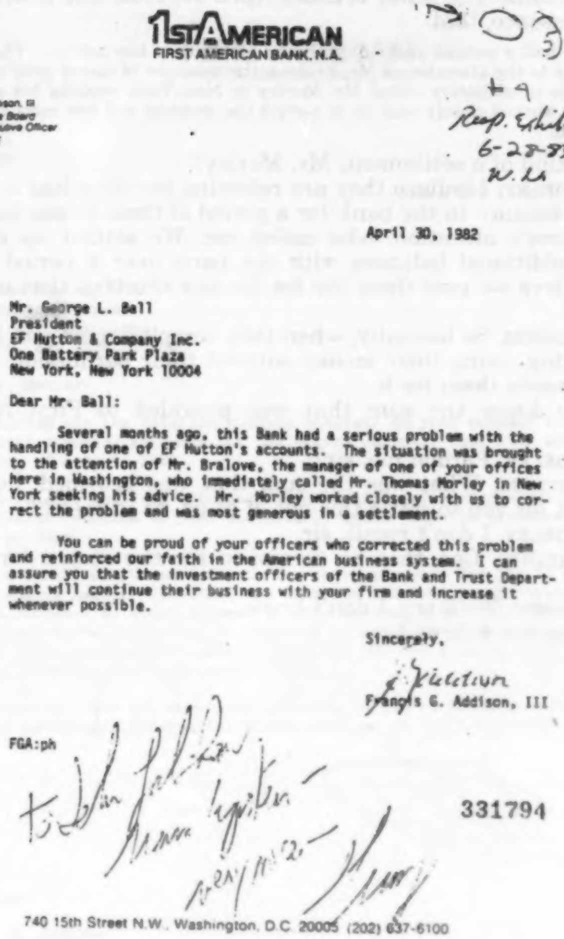
Memo from **George L. Ball**

May 10, 1982

To: John Latshaw
Norm Epstein

Very nice--

George
GLB:pz



1ST AMERICAN
FIRST AMERICAN BANK, N.A.

Francis G. Addison, III
Chairman of the Board
and Chief Executive Officer
(202) 637-7800

+9
Resp. Exhibit #7
6-28-85 [illegible]
[illegible]

April 30, 1982

Mr. George L. Ball
President
EF Hutton & Company Inc.
One Battery Park Plaza
New York, New York 10004

Dear Mr. Ball:

Several months ago, this Bank had a serious problem with the handling of one of EF Hutton's accounts. The situation was brought to the attention of Mr. Bralove, the manager of one of your offices here in Washington, who immediately called Mr. Thomas Morley in New York seeking his advice. Mr. Morley worked closely with us to correct the problem and was most generous in a settlement.

You can be proud of your officers who corrected this problem and reinforced our faith in the American business system. I can assure you that the investment officers of the Bank and Trust Department will continue their business with your firm and increase it whenever possible.

Sincerely,

Francis G. Addison, III

FGA:ph

To John [illegible] [illegible] [illegible] — MAY 11 '82 — [illegible]

331794

740 15th Street N.W., Washington, D.C. 20005 (202) 637-6100

Mr. **Hughes**. The letter is dated April 30, 1982, and it says to Mr. Ball, in essence, that:

> We have had a serious problem with the handling of the account. The situation was brought to the attention of Mr. Bralove, the manager of one of your offices here in D.C., who immediately called Mr. Morley in New York, seeking his advice. Mr. Morley has worked closely with us to correct the problem and was most generous in a settlement.

What kind of a settlement, Mr. Morley?

Mr. **Morley**. I believe they are referring to—they had a negative collected balance in the bank for a period of time. It was brought to Mr. Bralove's attention, who called me. We settled up as far as leaving additional balances with the bank over a period of time, and I believe we paid them the fee for any shortfall that may have occurred.

Mr. **Hughes**. So basically, when they complain that you had been overdrafting, using their money without their permission, you had to compensate them for it.

Do you know the sum that was provided to First American Bank?

Mr. **Morley**. Pardon me, sir?

Mr. **Hughes**. What was the sum that was provided, how much did it cost for you to settle this out of court, so to speak?

Mr. **Morley**. I don't recall, sir.

Mr. **Hughes**. Can that be furnished for the record for us, Mr. Fomon?

Mr. **Fomon**. We'll try. I don't know.

[Information follows:]

1ST AMERICAN
FIRST AMERICAN BANK, N.A.

John A. Pecilunas
Vice President
(202) 637-6333

March 10, 1982

Mr. Tomas Morley
E. F. Hutton Company
One Battery Park Plaza
New York, New York 10005

Dear Mr. Morley:

Enclosed are the detailed account analysis on your company's two commercial checking accounts for the entire calendar year 1981 and for the month of January 1982.

I have also enclosed a summary report which reflects the net investable balance position of your accounts by month with the corresponding income or loss.

As a result of the activity in the above accounts for the 13 month period ending January 31, 1982, the Bank has incurred a net revenue loss of $114,510.38. In order to make up this revenue short fall on a balance requirement basis, you would be required to maintain an approximate average daily investable balance of $10,500,000 for a month based on our February earnings credit rate of 14.08%.

Should you have any questions relative to the enclosed material or need any additional information please call me at (202) 637-6333.

Sincerely,

John A. Pecilunas

Enclosures

cc: F. G. Addison
Chairman of the Board

bcc: E. F. Hutton File ✓
JAP File

n, D.C. 20005 (202) 637-6100

Month		Additional Balance Available/Required		Earnings Credit Rate For The Month		Net Income/ Loss
January	1981	311.69	+	17.04	=	4.65
February		20,781.68	+	16.88	=	269.08
March		(8,152.23)	+	15.55	=	(107.57)
April		51,235.06	+	14.10	=	593.70
May		243,485.01	+	14.34	=	2,965.46
June		(84,999.27)	+	17.32	=	(1,209.90)
July		(648,937.06)	+	16.71	=	(9,209.79)
August		(1,839,681.01)	+	16.79	=	(26,233.75)
September		(2,669,789.54)	+	16.91	=	(37,106.40)
October		(2,154,631.64)	+	15.70	=	(28,730.49)
November		(2,261,548.64)	+	11.75	=	(21,840.90)
December		(2,214,010.07)	+	11.29	=	(21,229.73)
		1981 Total				(141,835.64)
January	1982	2,539,335.69	+	12.67	=	27,325.26
		13 Month Total				(114,510.38)
February	1982					1,589.62
						(112,920.91)

1STAMERICAN
FIRST AMERICAN BANK, N.A.

John A. Peciunas
Vice President
(202) 637-6333

April 6, 1982

Mr. Thomas Morley
E. F. Hutton Company
One Battery Park Place
New York, New York 10005

Dear Tom:

Enclosed is a copy of the March account analysis for your company's two checking accounts. The excess balance position during March generated an income of $3,829.82.

Following is a summary of your balance deficiencies for the time period January 1981 thru March 1982:

		Net Income/(Loss)
Calander Year 1981	(Per March 10 Letter)	($141,835.64)
	Excess Balances Available	
January 1982	$2,539,330	27,325.26
February 1982	147,180	1,589.67
March 1982	339,560	3,829.82
		($109,090.89)

If you have any questions or need additional information, please call me at the above listed phone number.

Sincerely,

John A. Peciunas

Enclosures (2)

cc: E. F. Hutton File ✓
JAP File

EF Hu[illegible]n & Company Inc.
Memb[illegible]w York Stock Exchange

EFHutton

One Battery Park Plaza
New York, New York 10004
Telephone (212) 742-5000

April 28, 1982

First American Bank
740 15th Street N. W.
Washington, DC 20005

Attn: John A. Pecilunas

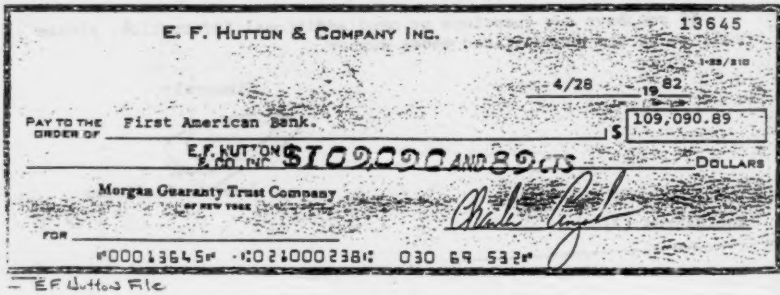
Dear John:

Enclosed is our check in the amount of $109,090.89. This represents the accumulated deficits in our account for all of 1981 and the first quarter of 1982.

Should you have any questions please feel free to call me.

Very truly yours,

Thomas P. Morley
First Vice President



E. F. HUTTON & COMPANY INC.

13645

1-28/210

4/28 19 82

PAY TO THE ORDER OF First American Bank. $ 109,090.89

E.F. HUTTON & CO. INC $109,090 AND 89 CTS DOLLARS

Morgan Guaranty Trust Company
OF NEW YORK

FOR

⑈0001364 5⑈ ⑆021000238⑆ 030 69 532⑈

— EF Hutton File

1stAMERICAN
FIRST AMERICAN BANK, N.A.

Francis G. Addison, III
Chairman of the Board
and Chief Executive Officer
(202) 637-7500

April 30, 1982

Mr. Thomas P. Morley
First Vice President
EF Hutton & Company Inc.
One Battery Park Plaza
New York, New York 10004

Dear Mr. Morley:

My sincere thanks for your wonderful cooperation in resolving our problem of accumulated deficits in EF Hutton's account. Your check was received today and has certainly revived my faith in the belief that not everybody in the world has lost sight of the fact that through cooperation, mistakes and misunderstandings can be easily put to rest.

I have already talked to Mr. Frisbee and Mr. Bralove thanking them for their efforts. Moreover, I have informed the investment officers of the Bank and Trust Department of the first-class treatment offered by your firm, and have asked them to reciprocate whenever possible.

Sincerely,

Francis G. Addison, III

FGA:ph

740 15th Street N.W., Washington, D.C. 20005 (202) 637-6100

READEX FICHE

1ST AMERICAN
FIRST AMERICAN BANK, N.A.

Francis G. Addison, III
Chairman of the Board
and Chief Executive Officer
(202) 637-7500

April 30, 1982

Mr. George L. Ball
President
EF Hutton & Company Inc.
One Battery Park Plaza
New York, New York 10004

Dear Mr. Ball:

Several months ago, this Bank had a serious problem with the handling of one of EF Hutton's accounts. The situation was brought to the attention of Mr. Bralove, the manager of one of your offices here in Washington, who immediately called Mr. Thomas Morley in New York seeking his advice. Mr. Morley worked closely with us to correct the problem and was most generous in a settlement.

You can be proud of your officers who corrected this problem and reinforced our faith in the American business system. I can assure you that the investment officers of the Bank and Trust Department will continue their business with your firm and increase it whenever possible.

Sincerely,

Francis G. Addison, III

FGA:ph

740 15th Street N.W. Washington, D.C. 20005 (202) 637-[illegible]

Mr. **Hughes**. Are you familiar with the settlement, Mr. Fomon?

Mr. **Fomon**. No.

Mr. **Hughes**. I also have a memo dated May 10, directed to John Latshaw.

Who is Mr. Latshaw?

Mr. **Fomon**. He is the regional vice president for the central region.

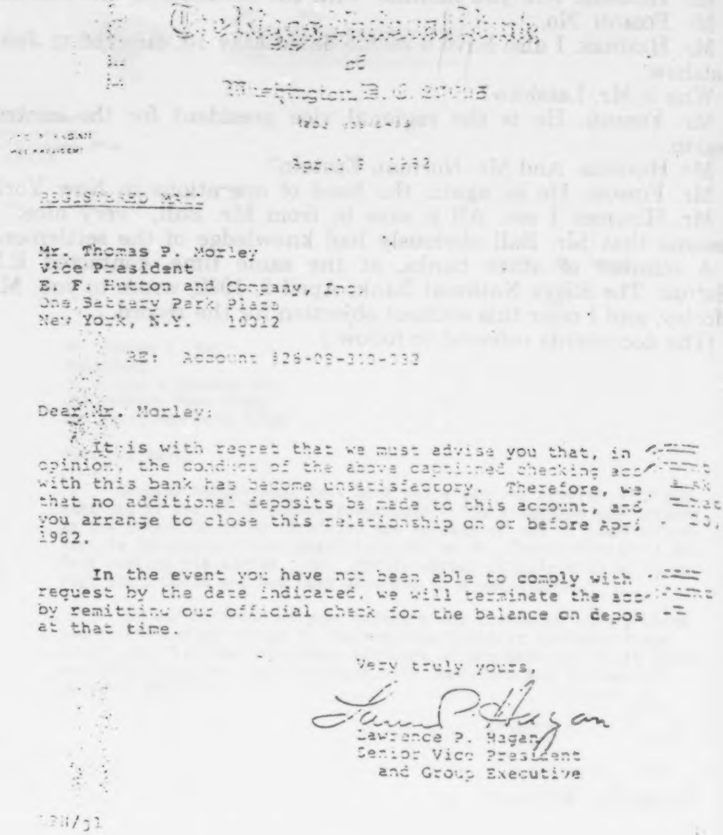
Mr. **Hughes**. And Mr. Norman Epstein?

Mr. **Fomon**. He is, again, the head of operations in New York.

Mr. **Hughes**. I see. All it says is, from Mr. Ball, "very nice." I assume that Mr. Ball obviously had knowledge of the settlement.

A number of other banks, at the same time, contacted E.F. Hutton. The Riggs National Bank, April 9, 1982, wrote to you, Mr. Morley, and I offer this without objection for the record.

[The documents referred to follow:]



[illegible]

Washington, D.C. [illegible]

April [illegible] 1982

REGISTERED MAIL

Mr. Thomas P. Morley
Vice President
E. F. Hutton and Company, Inc.
One Battery Park Place
New York, N.Y. 10012

RE: Account #26-08-310-032

Dear Mr. Morley:

It is with regret that we must advise you that, in opinion, the conduct of the above captioned checking acc with this bank has become unsatisfactory. Therefore, we that no additional deposits be made to this account, and you arrange to close this relationship on or before Apri 20, 1982.

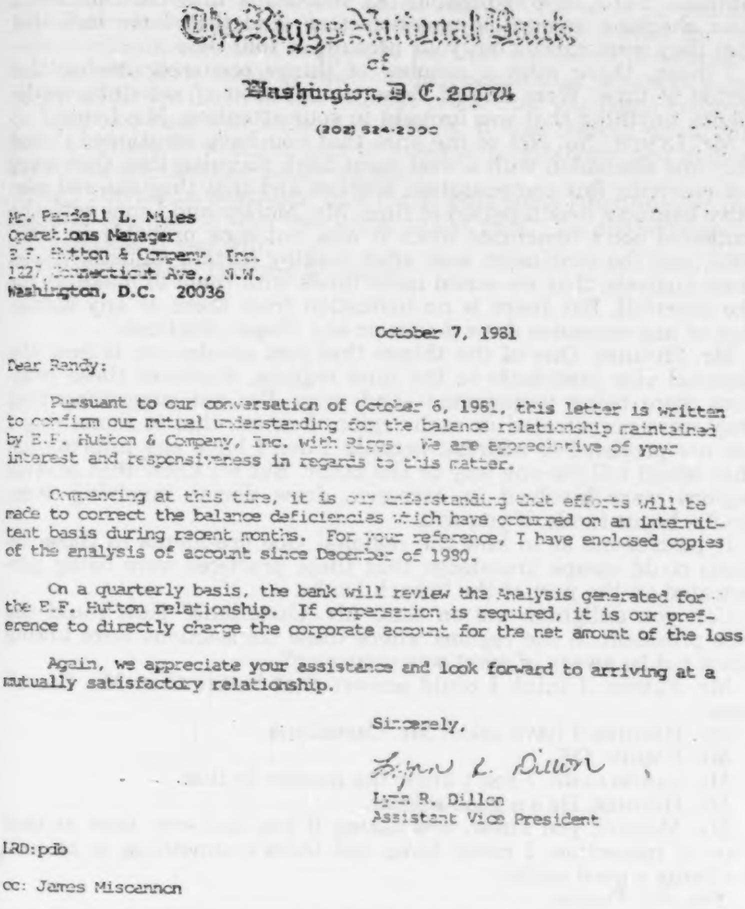
In the event you have not been able to comply with request by the date indicated, we will terminate the acc by remitting our official check for the balance on depos at that time.

Very truly yours,

Lawrence P. Hagan

Lawrence P. Hagan
Senior Vice President
and Group Executive

LPH/jl



The Riggs National Bank
of
Washington, D. C. 20074
(202) 524-2000

Mr. Randell L. Miles
Operations Manager
E.F. Hutton & Company, Inc.
1227 Connecticut Ave., N.W.
Washington, D.C. 20036

October 7, 1981

Dear Randy:

Pursuant to our conversation of October 6, 1981, this letter is written to confirm our mutual understanding for the balance relationship maintained by E.F. Hutton & Company, Inc. with Riggs. We are appreciative of your interest and responsiveness in regards to this matter.

Commencing at this time, it is our understanding that efforts will be made to correct the balance deficiencies which have occurred on an intermittent basis during recent months. For your reference, I have enclosed copies of the analysis of account since December of 1980.

On a quarterly basis, the bank will review the Analysis generated for the E.F. Hutton relationship. If compensation is required, it is our preference to directly charge the corporate account for the net amount of the loss.

Again, we appreciate your assistance and look forward to arriving at a mutually satisfactory relationship.

Sincerely,

Lynn R. Dillon

Lynn R. Dillon
Assistant Vice President

LRD:pdb

cc: James Miscannon

Mr. HUGHES. And it's referenced to the account with the Riggs National Bank of Washington, DC, indicating that the conduct of your checking account is unsatisfactory, and they have indicated that they were closing out your account at that time.

I mean, there were a number of things occurring during this period of time. Were any of these cancellation of accounts, settlements, anything that was brought to your attention, Mr. Lynch?

Mr. LYNCH. No. Not of the ones that you have mentioned. I had only one discussion with a west coast bank claiming that they were not receiving fair compensation services and that they showed negative balances over a period of time. Mr. Morley and I met with the banker. I don't remember when it was, but back probably in 1981, 1982, and the conclusion was, after making certain adjustments in their analysis, that we would leave funds with them to make up for the shortfall. But there is no indication from them or any discussion of any excessive draw downs or any illegal practices.

Mr. HUGHES. One of the things that just puzzles me is how the regional vice presidents in the nine regions, wherever these practices were being perpetrated—and, now, I'm not suggesting that they were perpetrated in each region. I mean, that is something I am not prepared to address, because I don't have any information that would tell me one way or the other. But we know that several regions were involved in excessive draw downs involving overdrafts, bogus funds, if you will.

It puzzles me as to how the regional vice presidents in those regions could escape knowledge that these practices were being perpetrated on the part of the branch banks.

Can you enlighten me on that, Mr. Castellano? How could the vice president in the regions where these transactions were taking place not be aware of what was occurring?

Mr. FOMON. I think I could answer that better than Mr. Castellano.

Mr. HUGHES. I have asked Mr. Castellano.

Mr. FOMON. OK.

Mr. CASTELLANO. I don't know the answer to that.

Mr. HUGHES. He's a good soldier.

Mr. Mazzoli, you know, was asking if you had ever been at that type of inspection. I never have, but there's something to be said for being a good soldier.

Yes, Mr. Fomon.

Mr. FOMON. I think that if a bank, a number of banks, had contacted the regional vice president about compensation problems, yes, he should have been alerted to look into it. But——

Mr. HUGHES. How could the excessive overdrafts occur without the regional vice president knowing about it?

I mean, you're talking about literally, you know, dozens and dozens of transactions involving chaining of checks across the country.

Mr. FOMON. His cashier would know about it, or his branch operations manager would know about it.

Mr. HUGHES. Can you imagine a cashier working for you that didn't do what you told him was proper?

Mr. FOMON. No.

Mr. HUGHES. I can't either, as a matter of fact.

Mr. Castellano, two memos that emanated from you, one dated February 9th of 1982 and one dated March 17th of 1982, dealing with interest on regional bank overdrafting, which I offer for the record without objection, suggest to me that a problem developed—I don't know how major it was—in the regions over who was going to get credit for much of the interest profit that was being generated. And the sum and substance of it is, it was bucked up to Mr. Ball, I believe it was, for him to attempt to arbitrate and decide, because it was a major policy decision.

Am I correct in assuming that there were some rumblings at the regional level as to who was going to get credit for the aggressive overdrafting, if you will?

[The documents referred to follow:]

EFHutton
INTER-OFFICE MEMORANDUM

FROM Michael P. Castellano
DATE March 17, 1982
SUBJECT Interest Earned on Regional Bank Overdrafting

After analyzing the branch system generation of interest dollars we have decided to credit interest profits generated via overdrafting of regional bank accounts by New York to the branches in each region. This would be in addition to interest profits earned via regional draw downs of branch accounts which are presently credited to the branches. Based on the philosophy that the regional operations and administration offices are not profit or loss centers, it would naturally flow that interest profits, as well as costs should not be retained.

To maintain the cost control and comparability features of the present regional interbranch system, these credits to branches must be in the form of a monthly journal entry to the general ledger interest line of each branch's P&L, rather than offsets to regional interbranch allocations.

This credit will be given each branch based upon its relative interest earned on bank balances vs. the total earned by the region. The first such credit will be processed in March for the first three months and will be booked monthly thereafter. A detailed memo explaining the methodology will be issued to the regional operations managers and I would suggest you clear any specific problems you may have with your respective Regional Operations Managers.

At the same time there will be a lesser but perceptible change in the interest earned by the branch system on outstanding Bank of America checks. In the past the cleared B of A checks did not hit the branch general ledger (account 2732) until one day after the bank debited our master account with them. This resulted in a branch's receiving one extra day's interest credit. Due to improvements in the B of A check system, the firm and branches will be both charged on the same day the B of A checks are processed by Bank of America.

Although this will somewhat mitigate the benefit gained on the regional overdrafting, based on historical data, the credit will exceed the charge. Those branches who draw down their bank accounts effectively will reap the greatest benefit from the above changes.

MC:jr

cc: G. Ball
N. Epstein
R. Genin
T. Lillis
T. Morley
Regional Operations Managers
Regional Vice Presidents

Hut
INTER-OFFICE MEMO

TO George Ball
FROM Michael P. Castellano
DATE February 9, 1982
SUBJECT Interest on Regional Bank Overdrafting

We should stress in the memo--which should go to BOMs--stressing how (fairly) we are doing this--would like to see before it's sent.

Although you have made the decision to give branches credit for interest earned via overdrafting of the Regional Bank Account, how these branch interest credits are determined and accounted for is still unresolved. The importance of this is underscored by the magnitude of these credits -- $5,400,000 or 28% of the $19,700,000 regional interbranch costs in 1981. (see attached)

Good point.

Accounting

I feel strongly that the interest should be allocated to branches as a credit in the interest category and not as an offset to regional interbranch charges. If the interest were accounted for as an offset to regional interbranch, incentives to control these rapidly growing costs would be reduced since, in a region with large regional overdraft interest credits, net regional costs would be cut in half.

Agree.

In addition, the recently implemented regional interbranch system would be undermined. The main reason it was changed was to standardize the allocation method and types of costs passed on to branches. If regional overdraft interest was used to reduce regional interbranch, standardization would be lost to the extent this interest varies from region to region. Since the same P&L effect can be achieved by a credit to the net interest total by branch, I believe this is a more reasonable approach. In discussion with Jim Daniel, he agreed completely.

The attached schedule indicates the magnitude of the $5.4 million by region and leads to more questions (as does everything that we seem to touch these days). Some of the questions raised are:

1. If New York is drawing down 30 branches in the Atlantic Region and 6 branches in the Central Region directly, are losing the extra float for the firm?
2. If the Mountain and South Central Regions are drawing down branches in other regions, how do we get the credit back to the proper branch (and region)?
3. Is the Southeast Region doing a poor job or are the credits being earned by the South Central Region?

Credit should--ideally--go to branches based on their balances being drawn down.

4. This calculation was made by asking the regions which bank accounts they were using to overdraft the branches. If there were other accounts then the $5.4 million would be somewhat higher.

I will review these questions with Tom Morley.

Allocation

I can think of three ways to compute each branches' share of this interest credit:

1. Calculating each branch's relative percent of total net interest vs. all branches in the region.
2. Calculating each branch's relative percent of total general ledger interest for all branches in the region. (the largest segment being bank account overdrafts).
3. Utilizing each branch's relative percent of regional interbranch allocation.

The second calculation seems to be the most equitable way of motivating branches with the best cash management since this interest line basically reflects interest earned from regional drawdowns of branch accounts. However, the first calculation, utilizing net interest would also be motivational and would stress better margin account cash management, free credits and short sales. Whichever we choose, a quarterly journal entry would be the most feasible way of handling the credit and it would be based on a year to date status.

I would appreciate your comments or if you would prefer to discuss it, please let me know. I will have to prepare a detailed memo instructing the Regional Vice Presidents' and Regional Operations Managers' of the decision and methodology.

KC:jr

cc: F. Hines

Mr. **Castellano**. Well, in answer to the question, it was brought to Mr. Ball's attention by, I believe, Dale Frye, who is one of the RVP's, that he thought that the interest credited through the internal interest credit that I explained earlier, the automated internal interest credit that was in the regions, should have been spread back to the branches rather than stay in the regions.

Mr. Ball came to me and said, "Mike, are you the chief accountant for the firm?"

"You set the interbranch policy of allocating the expenses. I would like you to recommend how we should allocate this interest credit as well."

And that is how I was brought into the picture.

Mr. **Hughes**. But the point I am trying to make is, some concern must have been directed to you and others from the regions, I presume, over the failure to get credit for some of the interest income that was being generated, quite a bit of interest income.

Mr. **Castellano**. To my knowledge, the only one who raised the question was Dale Frye, who went to George Ball and then came to me.

Mr. **Fomon**. Could I comment?

Mr. **Hughes**. Please do.

Mr. **Fomon**. That memo, what is the date of that memo?

Mr. **Hughes**. February 9, 1982.

Mr. **Fomon**. They, for years, branch managers were beating on George Ball to have more interest credit, more interest profit credited to their specific branch instead of to the region. That is what that memo is about. That memo was not written, addressing itself to the illegal excessive draw downs, multiple transfers.

Mr. **Hughes**. I didn't suggest that.

Mr. **Fomon**. I just wanted to make sure that you understood.

Mr. **Hughes**. I didn't suggest that, no.

I think the point I am trying to make is that there was a great deal of internal pressure within the company to maximize the interest.

Mr. **Fomon**. That is correct.

Mr. **Hughes**. Which I think supports one of my concerns, is that the internal workings of E.F. Hutton encouraged some of the practices that have now been stopped by an injunction and stopped because of a criminal prosecution to some extent.

Mr. **Fomon**. You're absolutely right.

Mr. **Hughes**. And insofar as the knowledge is concerned, I think the documents also support the proposition that there were enough signs, excessive amounts of drafts and checks carried on the ledgers, $400 million in amounts. There were checks being bounced in huge sums, accounts being closed, possibly training sessions where these practices were discussed. And we have to assume that they were discussed within the industry. I mean, these things don't occur—you can't have salesmen making money in the branch offices and not talking about the practices that lead to the successes.

The memorandum to Mr. Ball from, I think it is, Ms. Curtiss, suggests to me that there was knowledge, certainly within your corporate offices, on the part of some individuals that there were aggressive draw downs or overdrafts, which, it seems to me, should have put somebody on notice, if they didn't have direct knowledge of the practice, that something was wrong.

And that is what gives me some great concern—great concern—about what took place between 1981 and—1979 and 1982—and some of the things that we've seen in the record suggest that "I'm not sure that we've fixed it yet."

Mr. FOMON. I don't understand.

Mr. HUGHES. Suggestions are we still have overdrafts, and it may be that they are just isolated incidents. We don't know because we don't have the records to support that.

Now, I believe that you are sincere in suggesting that you've attempted, you know, to change the practice. But you know, Mr. Fomon, the best way to persuade us that you have changed the practice is to show us the memorandums that put your best foot forward.

Mr. FOMON. I'm going to.

Mr. HUGHES. I would have thought that that would be in the first box of memorandums that were submitted to us.

Mr. FOMON. I am surprised it was not.

Mr. HUGHES. I can tell you it's not. It's not even in the 62d box.

Mr. FOMON. I can believe you.

Mr. HUGHES. I can assure you if it were there, we would have found it; because we found all these other things.

The gentleman——

Mr. MORRISON. I just have one brief question.

When we were talking before, when I was asking before about these drafts and checks payable items that are on the filings with the SEC, and we talked about $400 million, we were talking about 1984 when we were talking about those numbers, which is 2 years after things changed.

Do you keep a monthly view issue, a monthly balance sheet of some kind that reflects these categories?

Mr. CASTELLANO. Yes, I do.

Mr. MORRISON. And there's one for May 31 and there will be one for June 30?

Mr. CASTELLANO. Well, we only file quarterly in detail with the SEC. I mean, I'd have the details that I have on the annual or quarterly on a monthly basis, but I certainly have it on a quarterly basis.

Mr. MORRISON. I would be very interested to see the first 6 months of this year with the quarterly that came on March 31 and the three before and after, if you would be willing to file that, because I think that would be interesting as to what I imagine we are going to see. I would think we would see a dramatic change, judging by what you have said.

Mr. CASTELLANO. I will supply those.

[Information furnished:]

O'MELVENY & MYERS

1800 M STREET, N. W.
WASHINGTON, D. C. 20036-5857
TELEPHONE (202) 457-5300
TELEX 89-622 (202) 833-2672 (DDD)

400 SOUTH HOPE STREET
LOS ANGELES, CALIFORNIA 90071-2899
TELEPHONE (213) 669-6000
TELEX 67-4122 · 4667795 (ITT)

1800 CENTURY PARK EAST
LOS ANGELES, CALIFORNIA 90067-1589
TELEPHONE (213) 553-6700
TELEX 67-4067

610 NEWPORT CENTER DRIVE
NEWPORT BEACH, CALIFORNIA 92660-6429
TELEPHONE (714) 760-9600 · (213) 669-6000
TELEX (714) 720-1397 (DDD) · 4720685 (ITT)

660 FIFTH AVENUE
NEW YORK, NEW YORK 10019
TELEPHONE (212) 247-4040
TELEX 127006

OUR FILE NUMBER

WRITER'S DIRECT TELEPHONE
(202) 457-5901

July
18th
1 9 8 5

The Honorable Bruce A. Morrison
437 Cannon House Office Building
Independence Avenue between C
and 1st St., S.E.
Washington, D.C. 20515

Dear Congressman Morrison:

On behalf of E. F. Hutton, I am forwarding the enclosed documents to you in response to your question about certain S.E.C. filings. Please do not hesitate to contact me if you have any further questions.

Sincerely,

Zoë Baird

Zoe E. Baird
for O'MELVENY & MYERS

Enclosures

ZEB:pnc

cc: Hayden W. Gregory, Esq. (w/o attachments)

FORM X-17A-5

4/81

FOCUS REPORT

(Financial and Operational Combined Uniform Single Report)

PART I OR PART II

☐ ☐ 10 ☒ ☐ 11

(Read instructions before preparing Form)

This report is being filed pursuant to (Check Applicable Block(s)):

1) Rule 17a-5(a) ☒ 16 2) Rule 17a-5(b) ☐ 17 3) Rule 17a-11 ☐ 18

4) Special request by designated examining authority ☐ 19 5) Other ☐ 26

NAME OF BROKER-DEALER: E.F. Hutton & Company Inc 13

SEC FILE NO. 14

FOR FIRM I.D. NO. 13-1937169 15

ADDRESS OF PRINCIPAL PLACE OF BUSINESS (Do not use P.O. Box No.)

One Battery Park Plaza 20

(No. and Street)

New York 21 New York 22 10004 23

(City) (State) (Zip)

FOR PERIOD BEGINNING (MM/DD/YY) May 1 1985 24

AND ENDING (MM/DD/YY) May 31 1985 25

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Carol A. Goldstein 30

(Area Code—Telephone No.) (212) 742-4210 31

NAME(S) OF SUBSIDIARIES OR AFFILIATES CONSOLIDATED IN THIS REPORT PURSUANT TO APPENDIX C OF RULE 15c3-1		CHECK IF GUARANTEED		CHECK IF FLOW THROUGH
E.F. Hutton International Inc.	32	X	50	33
	34		51	35
	36		52	37
	38		53	39

DOES RESPONDENT CARRY ITS OWN CUSTOMER ACCOUNTS? YES ☒ 40 NO ☐ 41

DOES RESPONDENT CLEAR TRANSACTIONS? YES ☒ 43 NO ☐ 44

CHECK HERE IF RESPONDENT IS FILING AN AUDITED REPORT ☐ 42

EXECUTION:

The registrant/broker or dealer submitting this Form and its attachments and the person(s) by whom it is executed represent hereby that all information contained therein is true, correct and complete. It is understood that all required items, statements, and schedules are considered integral parts of this Form and that the submission of any amendment represents that all unamended items, statements and schedules remain true, correct and complete as previously submitted. See general instructions for reporting contractural and contingent liabilities.

Dated the 25th day of June 19 85

Manual Signatures of:

1) ______________________
Principal Executive Officer or Managing Partner

2) ______________________
Principal Financial Officer or Partner

3) ______________________
Principal Operations Officer or Partner

ATTENTION— Intentional misstatements or omissions of facts constitute Federal Criminal Violations. (See 18 U.S.C. 1001 and 15 U.S.C. 78ff (a))

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton + Company, Inc N 2 [100]

STATEMENT OF FINANCIAL CONDITION

As of (MM/DD/YY) May 31, 1985 [99]

SEC FILE NO. ______ [98]

Consolidated ☒ [198]
Unconsolidated ☐ [199]

ASSETS

	Allowable		Nonallowable		Total	
1. Cash	$ 69 029 000	200			$ 69 029 000	750
2. Cash segregated in compliance with federal and other regulations	67 699 000	210			67 699 000	760
3. Receivable from brokers or dealers and clearing organizations:						
A. Failed to deliver:						
1. Includable in "Formula for Reserve Requirements"	42 294 000	220				
2. Other	41 743 000	230			84 037 000	770
B. Securities borrowed:						
1. Includable in "Formula for Reserve Requirements"	120 916 000	240				
2. Other	879 347 000	250			1 000 263 000	780
C. Omnibus accounts:						
1. Includable in "Formula for Reserve Requirements"	- 0 -	260				
2. Other	5 264 000	270			5 264 000	790
D. Clearing organizations:						
1. Includable in "Formula for Reserve Requirements"	6 410 000	280				
2. Other	47 030 000	290			53 440 000	80
E. Other	229 259 000	300	$ - 0 -	550	229 259 000	81
Receivables from customers:						
A. Securities accounts:						
1. Cash and fully secured accounts	1744 097 000	310				
2. Partly secured accounts	124 000	320	22 000	560		
3. Unsecured accounts			12 154 000	570		
B. Commodity accounts	58 362 000	330	27 468 000	580		
C. Allowance for doubtful accounts	(- 0 -)	335	(27 218 000)	590	1815 009 000	82
Receivables from non-customers:						
A. Cash and fully secured accounts	24 389 000	340				
B. Partly secured and unsecured accounts	- 0 -	350	- 0 -	600	24389 000	83
Securities purchased under agreements to resell	638, 959 000	360	- 0 -	605	628, 959 000	84
Securities and spot commodities owned, at market value:						
A. Bankers acceptances, certificates of deposit and commercial paper	1 567 337 000	370				
B. U.S. and Canadian government obligations	1 436 377 000	380				
C. State and municipal government obligations	348 943 000	390				
D. Corporate obligations	505 438 000	400				

OMIT PENNI

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. HUTTON + Company Inc as of MAY 31, 1985

STATEMENT OF FINANCIAL CONDITION

ASSETS

	Allowable		Nonallowable		Total	
E. Stocks and warrants	$ 408183000	410				
F. Options	39571000	420				
G. Arbitrage	- 0 -	422				
H. Other securities	72777000	424				
I. Spot commodities	44362000	430			$ 4412988000	850
8. Securities owned not readily marketable:						
A. At Cost $ - 0 - [130]						
B. At estimated fair value	- 0 -	440	$ - 0 -	610	- 0 -	860
9. Other investments not readily marketable:						
A. At Cost $ 3090000 [140]						
B. At estimated fair value	- 0 -	450	1518000	620	1518000	870
10. Securities borrowed under subordination agreements and partners' individual and capital securities accounts, at market value:						
A. Exempted securities $ - 0 - [150]						
B. Other $ - 0 - [160]	- 0 -	460	- 0 -	630	- 0 -	880
11. Secured demand notes-market value of collateral:						
A. Exempted securities $ - 0 - [170]						
B. Other $ - 0 - [180]	- 0 -	470	- 0 -	640	- 0 -	890
12. Memberships in exchanges:						
A. Owned, at market value $ [190]						
B. Owned at cost			5161000	650		
C. Contributed for use of company, at market value			- 0 -	660	5161000	900
13. Investment in and receivables from affiliates, subsidiaries and associated partnerships	- 0 -	480	6931000	670	6931000	910
14. Property, furniture, equipment, leasehold improvements and rights under lease agreements: At cost (net of accumulated depreciation and amortization)	- 0 -	490	166584000	680	166584000	920
15. Other Assets:						
A. Dividends and interest receivable	13605000	500	4585000	690		
B. Free shipments	4700000	510	557000	700		
C. Loans and advances	- 0 -	520	33612000	710		
D. Miscellaneous	111492000	530	135790000	720	994341000	930
16. TOTAL ASSETS	$ 1496707000	540	$ 357164000	740	$ 1461789000	940

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FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F Hutton + Company Inc as of May 31, 1985

STATEMENT OF FINANCIAL CONDITION

LIABILITIES AND OWNERSHIP EQUITY

Liabilities	A.I. Liabilities *	Non-A.I. Liabilities *	Total
17. Bank loans payable:			
A. Includable in "Formula for Reserve Requirements"	$ [1030]	$ [1240]	$ 262 760 000 [1460]
B. Other	[1040]	[1250]	530 143 000 [1470]
18. Securities sold under repurchase agreements		[1260]	6463299 000 [1480]
19. Payable to brokers or dealers and clearing organizations:			
A. Failed to receive:			
1. Includable in "Formula for Reserve Requirements"	[1050]	[1270]	25 918 000 [1490]
2. Other	[1060]	[1280]	1288 845 000 [1500]
B. Securities loaned:			
1. Includable in "Formula for Reserve Requirements"	[1070]		485 507 000 [1510]
2. Other	[1080]	[1290]	483 988 000 [1520]
C. Omnibus accounts:			
1. Includable in "Formula for Reserve Requirements"	[1090]		-0- [1530]
2. Other	[1095]	[1300]	6319 000 [1540]
D. Clearing organizations:			
1. Includable in "Formula for Reserve Requirements"	[1100]		6429 000 [1550]
2. Other	[1105]	[1310]	2345 000 [1560]
E. Other	[1110]	[1320]	51 910 000 [1570]
20. Payable to customers:			
A. Securities accounts - including free credits of $ 996 545 000 [950]	[1120]		1014 986 000 [1580]
B. Commodities accounts	[1130]	[1330]	161 642 000 [1590]
21. Payable to non customers:			
A. Securities accounts	[1140]	[1340]	1227 000 [1600]
B. Commodities accounts	[1150]	[1350]	313 000 [1610]
22. Securities sold not yet purchased at market value - including arbitrage of $ 0 [960]		[1360]	1875153000 [1620]
23. Accounts payable and accrued liabilities and expenses:			
A. Drafts payable	[1160]		714 000 [1630]
B. Accounts payable	[1170]		168 304 000 [1640]
C. Income taxes payable	[1180]		54 268 000 [1650]
D. Deferred income taxes		[1370]	-0- [1660]
E. Accrued expenses and other liabilities	[1190]		1018 449 000 [1670]
F. Other	[1200]	[1380]	70 389 000 [1680]

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*Brokers or Dealers electing the alternative net capital requirement method need not complete these columns.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. Hutton + Company Inc as of May 31, 1985

STATEMENT OF FINANCIAL CONDITION

LIABILITIES AND OWNERSHIP EQUITY (continued)

Liabilities	A.I. Liabilities *		Non-A.I. Liabilities *		Total	
24. Notes and mortgages payable:						
A. Unsecured	$	1210			$ – 0 –	1690
B. Secured	$	1211	$	1390	– 0 –	1700
25. Liabilities subordinated to claims of general creditors:						
A. Cash borrowings				1400	153 480 000	1710
1. from outsiders $ 16 000 000 [870]						
2. Includes equity subordination (15c3-1 (d)) of $ – 0 – [880]						
B. Securities borrowings, at market value: from outsiders $ – 0 – [890]				1410	– 0 –	1720
C. Pursuant to secured demand note collateral agreements:				1420	$ – 0 –	1730
1. from outsiders $ – 0 – [1000]						
2. Includes equity subordination (15c3-1 (d)) of $ – 0 – [1010]						
D. Exchange memberships contributed for use of company at market value			$	1430	– 0 –	1740
E. Accounts and other borrowings not qualified for net capital purposes		1220		1440	3 459 000	1750
26. TOTAL LIABILITIES	$	1230	$	1450	$ 14 117 645 000	1760

Ownership Equity

27. Sole proprietorship	$	1770
28. Partnership- limited partners $ [1020]		1780
29. Corporation:		
A. Preferred stock	– 0 –	1791
B. Common stock	$ 2 000	1792
C. Additional paid-in capital	95 914 000	1793
D. Retained earnings	404 310 000	1794
E. Total	500 226 000	1795
F. Less capital stock in treasury	(– 0 –)	1796
30. TOTAL OWNERSHIP EQUITY	$ 500 226 000	1800
31. TOTAL LIABILITIES AND OWNERSHIP EQUITY	$ 14 617 871 000	1810

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*Brokers or Dealers electing the alternative net capital requirement method need not complete these columns.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton + Company · Inc as of May 31, 1985

COMPUTATION OF NET CAPITAL

1. Total ownership equity (from Statement of Financial Condition – Item 1800)					$ 500 226 000	3480
2. Deduct: Ownership equity not allowable for net capital					(– 0 –)	3490
3. Total ownership equity qualified for net capital						3500
4. Add:						
A. Liabilities subordinated to claims of general creditors allowable in computation of net capital					153 480 000	3520
B. Other (deductions) or allowable credits (List)					– 0 –	3525
5. Total capital and allowable subordinated liabilities					$ 653 706 000	3530
6. Deductions and/or charges:						
A. Total non-allowable assets from Statement of Financial Condition (Note B and C)			$ 357 964 000	3540		
1. Additional charges for customers' and non-customers' security accounts			6 507 000	3550		
2. Additional charges for customers' and non-customers' commodity accounts			2 134 000	3560		
B. Aged fail-to-deliver:			1 966 000	3570		
1. Number of items	636	3450				
C. Aged short security differences-less reserve of	$ – 0 –	3460	164 000	3580		
number of items		3470				
D. Secured demand note deficiency			– 0 –	3590		
E. Commodity futures contracts and spot commodities – proprietary capital charges			260 000	3600		
F. Other deductions and/or charges			1 663 000	3610		
G. Deductions for accounts carried under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x)			– 0 –	3615		
H. Total deductions and/or charges					(370 658 000)	3620
7. Other additions and/or allowable credits (List)					– 0 –	3630
8. Net Capital before haircuts on securities positions					$ 283 048 000	3640
9. Haircuts on securities: (computed, where applicable, pursuant to 15c3-1 (f)):						
A. Contractual securities commitments			2 151 000	3660		
B. Subordinated securities borrowings			– 0 –	3670		
C. Trading and investment securities:						
1. Bankers' acceptances, certificates of deposit and commercial paper			6 339 000	3680		
2. U.S. and Canadian government obligations			16 031 000	3690		
3. State and municipal government obligations			17 344 000	3700		
4. Corporate obligations			40 086 000	3710		
5. Stocks and warrants			23 442 000	3720		
6. Options			13 557 000	3730		
7. Arbitrage			– 0 –	3732		
8. Other securities			7 107 000	3734		
D. Undue concentration			– 0 –	3650		
E. Other (list) Gov Parity Short Acct			19 000	3736	(195 076 000)	3740
10. Net Capital					$ 87 972 000	3750

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FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. HUTTON + COMPANY INC

as of MAY 31, 1985

COMPUTATION OF BASIC NET CAPITAL REQUIREMENT

Part A

11. Minimum net capital required (6-2/3% of line 19)	$		3756
12. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)	$		3758
13. Net capital requirement (greater of line 11 or 12)	$		3760
14. Excess net capital (line 10 less 13)	$		3770
15. Excess net capital at 1000% (line 10 less 10% of line 19)	$		3780

COMPUTATION OF AGGREGATE INDEBTEDNESS

16. Total A.I. liabilities from Statement of Financial Condition			$		3790
17. Add:					
A. Drafts for immediate credit	$	3800			
B. Market value of securities borrowed for which no equivalent value is paid or credited	$	3810			
C. Other unrecorded amounts (List)	$	3820	$		3830
18. Deduct: Adjustment based on deposits in Special Reserve Bank Accounts (15c3-1 (c) (1) (vii))			$		3838
19. Total aggregate indebtedness			$		3840
20. Percentage of aggregate indebtedness to net capital (line 19 ÷ by line 10)			%		3850
21. Percentage of Aggregate Indebtedness to net capital after anticipated capital withdrawals (line 19 ÷ by line 10 less Item 4880 page 11)			%		3853

COMPUTATION OF ALTERNATE NET CAPITAL REQUIREMENT

Part B

22. 4% of combined aggregate debit items as shown in Formula for Reserve Requirements pursuant to Rule 15c3-3 prepared as of the date of the net capital computation including both brokers or dealers and consolidated subsidiaries' debits	$	35 936 000	3870
23. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)	$	40 021 000	3880
24. Net capital requirement (greater of line 22 or 23)	$	40 021 000	3760
25. Excess net capital (line 10 less 24)	$	117 951 600	3910
26. Percentage of Net Capital to Aggregate Debits (line 10 ÷ by line 17 page 8)	%	7 90	3851
27. Percentage of Net Capital, after anticipated capital withdrawals, to Aggregate Debits (line 10 less Item 4880 page 11 ÷ by line 17 page 8)	%	6 76	3854
28. Net capital in excess of the greater of:			
A. 5% of combined aggregate debit items or $120,000	$	77 930	3920
B. 7% of combined aggregate debit items or $120,000	$	57 930	3930

OTHER RATIOS

Part C

29. Percentage of debt to debt-equity total computed in accordance with Rule 15c3-1 (d)	%	23 48	3860
30. Options deductions/Net Capital ratio (1000% test) total deductions exclusive of liquidating equity under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x) ÷ Net Capital	%		3852

NOTES:

(A) The minimum net capital requirement should be computed by adding the minimum dollar net capital requirement of the reporting broker dealer and, for each subsidiary to be consolidated, the greater of:
1. Minimum dollar net capital requirement, or
2. 6-2/3% of aggregate indebtedness or 4% of aggregate debits if alternative method is used.

(B) Do not deduct the value of securities borrowed under subordination agreements or secured demand notes covered by subordination agreements not in satisfactory form and the market values of memberships in exchanges contributed for use of company (contra to item 1740) and partners' securities which were included in non-allowable assets.

(C) For reports filed pursuant to paragraph (d) of Rule 17a-5, respondent should provide a list of material non-allowable assets.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. Hutton + Company Inc as of May 31, 1985

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS FOR BROKER-DEALERS UNDER RULE 15c3-3
(See Rule 15c3-3, Exhibit A and Related Notes)

CREDIT BALANCES

1.	Free credit balances and other credit balances in customers' security accounts (see Note A, Exhibit A, Rule 15c3-3)	$1,057,677,000	4340		
2.	Monies borrowed collateralized by securities carried for the accounts of customers (see Note B)	30,000,000	4350		
3.	Monies payable against customers' securities loaned (see Note C)	475,507,000	4360		
4.	Customers' securities failed to receive (see Note D)	118,575,000	4370		
5.	Credit balances in firm accounts which are attributable to principal sales to customers	205,360,000	4380		
6.	Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days	19,000	4390		
7.	**Market value of short security count differences over 30 calendar days old	22,000	4400		
8.	**Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days	4,866,000	4410		
9.	Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days	4,972,000	4420		
10.	Other (List)	-0-	4425		
11.	TOTAL CREDITS			$1,896,998,000	4430

DEBIT BALANCES

12.	**Debit balances in customers' cash and margin accounts excluding unsecured accounts and accounts doubtful of collection net of deductions pursuant to Note E, Exhibit A, Rule 15c3-3	$1,641,049,000	4440		
13.	Securities borrowed to effectuate short sales by customers and securities borrowed to make delivery on customers' securities failed to deliver	120,916,000	4450		
14.	Failed to deliver of customers' securities not older than 30 calendar days	237,830,000	4460		
15.	Margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in customer accounts (See Note F)	-0-	4465		
16.	Other (List)	-0-	4469		
17.	**Aggregate debit items			$1,999,795,000	4470
18.	**less 3% (for alternative method only — see Rule 15c3-1 (f) (5) (i))			(59,994,000)	4471
19.	**TOTAL 15c3-3 DEBITS			$1,939,801,000	4472

RESERVE COMPUTATION

20.	Excess of total debits over total credits (line 19 less line 11)	$ 42,803,000	4480
21.	Excess of total credits over total debits (line 11 less line 19)		4490
22.	If computation permitted on a monthly basis, enter 105% of excess of total credits over total debits		4500
23.	Amount held on deposit in "Reserve Bank Account(s)", including value of qualified securities, at end of reporting period		4510
24.	Amount of deposit (or withdrawal) including $____ [4515] value of qualified securities		4520
25.	New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including $____ [4525] value of qualified securities	$	4530
26.	Date of deposit (MMDDYY)		4540

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FREQUENCY OF COMPUTATION

27. Daily ____ 4332 Weekly ✓ 4333 Monthly ____ 4334

**In the event the Net Capital Requirement is computed under the alternative method, this "Reserve Formula" shall be prepared in accordance with the requirements of paragraph (f) of Rule 15c3-1.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. Hutton + Company Inc as of May 31, 1985

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS
FOR BROKER-DEALERS UNDER RULE 15c3-3 (continued)

EXEMPTIVE PROVISIONS

25. If an exemption from Rule 15c3-3 is claimed, identify below the section upon which such exemption is based (check one only)

A. (k) (1)—$2,500 capital category as per Rule 15c3-1		4550
B. (k) (2)(A)—"Special Account for the Exclusive Benefit of customers" maintained		4560
C. (k) (2)(B)—All customer transactions cleared through another broker-dealer on a fully disclosed basis. Name of clearing firm ______ 4335		4570
D. (k) (3)—Exempted by order of the Commission		4580

Information for Possession or Control Requirements Under Rule 15c3-3

State the market valuation and the number of items of:

1. Customers' fully paid securities and excess margin securities not in the respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frames specified under Rule 15c3-3. Notes A and B	$ — 0 —	4586
A. Number of items	— 0 —	4587
2. Customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of the report date, excluding items arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3. Notes B, C and D	$	4588
A. Number of items		4589

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3. The system and procedures utilized in complying with the requirement to maintain physical possession or control of customers' fully paid and excess margin securities have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 15c3-3 .... Yes X 4584 No ______ 4585

NOTES

A—Do not include in item one customers' fully paid and excess margin securities required by Rule 15c 3-3 to be in possession or control but for which no action was required by the respondent as of the report date or required action was taken by respondent within the time frames specified under Rule 15c3-3.

B—State separately in response to items one and two whether the securities reported in response thereto were subsequently reduced to possession or control by the respondent.

C—Be sure to include in item two only items not arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3.

D—Item two must be responded to only with report which is filed as of the date selected for the broker's or dealer's annual audit of financial statements, whether or not such date is the end of a calendar quarter. The response to item two should be filed within 60 calendar days after such date, rather than with the remainder of this report. This information may be required on a more frequent basis by the Commission or the designated examining authority in accordance with Rule 17a-5(a)(2)(iv).

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc as of May 31, 1985

SCHEDULE OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION

CUSTOMERS' REGULATED COMMODITY FUTURES ACCOUNTS

SEGREGATION REQUIREMENTS

1. Net ledger balance		
a. Cash	$ 115 501 000	7010
b. Securities (at market)	203 155 000	7020
2. Net unrealized profit (loss) in open futures contracts	(6 060 000)	7030
3. Net equity (Deficit) (Total of 1 - plus or minus 2)	312 596 000	7040
4. Add: accounts liquidating to a deficit and accounts with debit balances with no open trades	19 943 000	7050
5. Amount required to be segregated (Total of 3 & 4	$ 332 539 000	7060

FUNDS ON DEPOSIT IN SEGREGATION

6. Deposited in segregated funds bank accounts:		
a. Cash	67 677 000	7070
b. Securities representing investments of customers' funds (at market)	51 800 000	7080
c. Securities held for customers in lieu of cash margins (at market)	203 155 000	7090
7. Margins on deposit with clearing organizations of contract markets:		
a. Cash	275 000	7100
b. Securities representing investments of customers' funds (at market)	16 055 000	7110
c. Securities held for customers in lieu of cash margins (at market)	- 0 -	7120
8. Settlement due from (to) contract market clearing organization	5 918 000	7130
9. Net equities with other FCMs	4 000	7140
10. Segregated funds on hand:		
a. Cash	- 0 -	7150
b. Securities representing investments of customers' funds (at market)	- 0 -	7160
c. Securities held for customers in lieu of cash margins (at market)	- 0 -	7170
11. Total amount in segregation (Total of 6 through 10)	$ 344 884 000	7180
12. Excess funds (insufficiency) in segregation (11 minus 5)	$ 12 345 000	7190

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton + Company Inc as of May 31, 1985

Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, (as defined below), which have not been deducted in the computation of Net Capital.

Type of Proposed withdrawal or Accrual See below for code to enter		Name of Lender or Contributor		Insider or Outsider? (In or Out)		Amount to be Withdrawn (cash amount and/or Net Capital Value of Securities)		(MMDDYY) Withdrawal or Maturity Date		Expect to Renew (yes or no)	
2	4600	First Interstate Bank	4601	out	4602	$ 1000000	4603	6/30/85	4604	no	4605
2	4610	First Interstate Bank	4611	out	4612	1000000	4613	9/30/85	4614	no	4615
	4620		4621		4622		4623		4624		4625
	4630		4631		4632		4633		4634		4635
	4640		4641		4642		4643		4644		4645
	4650		4651		4652		4653		4654		4655
	4660		4661		4662		4663		4664		4665
	4670		4671		4672		4673		4674		4675
	4680		4681		4682		4683		4684		4685
5	4690		4691		4692	30884000	4693		4694		4695

TOTAL $ 32884000 4699*

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*To agree with the total on Recap (Item No. 4880)

Instructions: Detail listing must include the total of items maturing during the six month period following the report date, regardless of whether or not the capital contribution is expected to be renewed. The schedule must also include proposed capital withdrawals scheduled within the six month period following the report date including the proposed redemption of stock and payments of liabilities secured by fixed assets (which are considered allowable assets in the capital computation pursuant to Rule 15c3-1(c)(2)(iv)), which could be required by the lender on demand or in less than six months.

WITHDRAWAL CODE:	DESCRIPTION
1.	Equity Capital
2.	Subordinated Liabilities
3.	Accruals
4.	15c3-1(c)(2)(iv) Liabilities
5	Aggregate Credit Extended to customers on Restricted Securities.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT

Capital Withdrawals

PART II

BROKER OR DEALER E. F. Hutton + Company Inc   For the period (MMDDYY) from May 1, 1985 to May 31, 1985

RECAP

Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, which have not been deducted in the computation of net capital.

1. **Equity Capital**		
A. Partnership Capital:		
1. General Partners	$	4700
2. Limited		4710
3. Undistributed Profits		4720
4. Other (describe below)		4730
5. Sole Proprietorship		4735
B. Corporation Capital:		
1. Common Stock		4740
2. Preferred Stock		4750
3. Retained Earnings (Dividends and Other)		4760
4. Other (describe below)		4770
2. **Subordinated Liabilities**		
A. Secured Demand Notes		4780
B. Cash Subordinations		4790
C. Debentures	2 000 000	4800
D. Other (describe below)		4810
3. **Other Anticipated Withdrawals**		
A. Bonuses		4820
B. Voluntary Contributions to Pension or Profit Sharing Plans		4860
C. Other (describe below)	20 884 000	4870
Total	$ 22 884 000	4880

4. **Description of Other**

3C- Aggregate Credit Extended to Customers on Restricted Securities

STATEMENT OF CHANGES IN OWNERSHIP EQUITY (SOLE PROPRIETORSHIP, PARTNERSHIP OR CORPORATION)

1. Balance, beginning of period			$ 487 869 000	4240
A. Net income (loss)			12 357 000	4250
B. Additions (Includes non-conforming capital of	$	4262)		4260
C. Deductions (Includes non-conforming capital of	$	4272)		4270
2. Balance, end of period (From item 1800)			$ 500 226 000	4290

STATEMENT OF CHANGES IN LIABILITIES SUBORDINATED TO CLAIMS OF GENERAL CREDITORS

3. Balance, beginning of period	$ 151 090 000	4300
A. Increases	3583 000	4310
B. Decreases	(1193 000)	4320
4. Balance, end of period (From item 3520)	$ 153 480 000	4330

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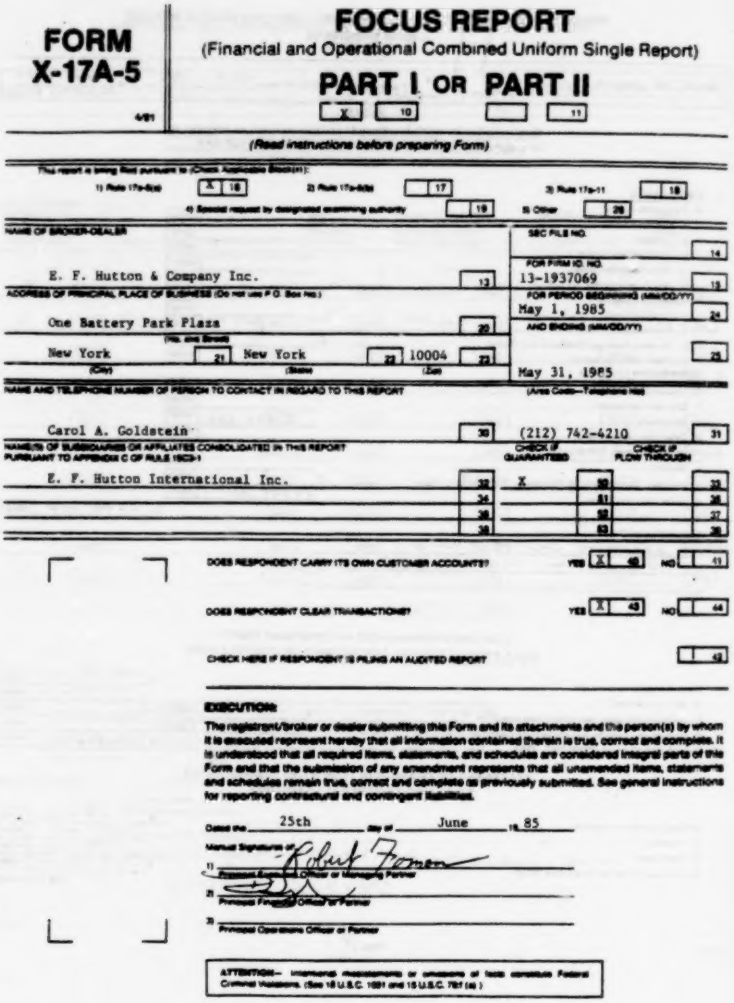

FORM X-17A-5

4/81

FOCUS REPORT

(Financial and Operational Combined Uniform Single Report)

PART I OR PART II

☒ 10 ☐ 11

(Read instructions before preparing Form)

This report is being filed pursuant to (Check Applicable Block(s)):

1) Rule 17a-5(a) ☒ 16
2) Rule 17a-5(b) ☐ 17
3) Rule 17a-11 ☐ 18
4) Special request by designated examining authority ☐ 19
5) Other ☐ 26

NAME OF BROKER-DEALER: E. F. Hutton & Company Inc. 13

SEC FILE NO. 14

FOR FIRM ID. NO.: 13-1937069 15

ADDRESS OF PRINCIPAL PLACE OF BUSINESS (Do not use P.O. Box No.)

One Battery Park Plaza 20
(No. and Street)

New York 21 New York 22 10004 23
(City) (State) (Zip)

FOR PERIOD BEGINNING (MM/DD/YY): May 1, 1985 24

AND ENDING (MM/DD/YY): May 31, 1985 25

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT: Carol A. Goldstein 30

(Area Code—Telephone No.): (212) 742-4210 31

NAME(S) OF SUBSIDIARIES OR AFFILIATES CONSOLIDATED IN THIS REPORT PURSUANT TO APPENDIX C OF RULE 15C3-1		CHECK IF GUARANTEED		CHECK IF FLOW THROUGH
E. F. Hutton International Inc.	32	X	50	33
	34		51	35
	36		52	37
	38		53	39

DOES RESPONDENT CARRY ITS OWN CUSTOMER ACCOUNTS? YES ☒ 40 NO ☐ 41

DOES RESPONDENT CLEAR TRANSACTIONS? YES ☒ 43 NO ☐ 44

CHECK HERE IF RESPONDENT IS FILING AN AUDITED REPORT ☐ 42

EXECUTION:

The registrant/broker or dealer submitting this Form and its attachments and the person(s) by whom it is executed represent hereby that all information contained therein is true, correct and complete. It is understood that all required items, statements, and schedules are considered integral parts of this Form and that the submission of any amendment represents that all unamended items, statements and schedules remain true, correct and complete as previously submitted. See general instructions for reporting contractural and contingent liabilities.

Dated the 25th day of June 19 85

Manual Signatures of:

1) Robert Fomon
Principal Executive Officer or Managing Partner

2)
Principal Financial Officer or Partner

3)
Principal Operations Officer or Partner

ATTENTION— Intentional misstatements or omissions of facts constitute Federal Criminal Violations. (See 18 U.S.C. 1001 and 15 U.S.C. 78ff (a))

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT

PART I
FOCUS REPORT

BROKER — DEALER

E. F. Hutton & Company Inc.

		ITEM
N 1	For Current Month	100
AS OF (MMDDYY)	May 31, 1985	99
SEC FILE NO.		98

ITEM	(OMIT PENNIES)	
1. Subordinated Loan Agreements—Cash	153,480,000	1710
2. Secured Demand Notes—Face Amount	-	1730
3. Total Subordinations Allowable for Net Capital	153,480,000	3520
4. Ownership Equity/Partnership Capital—Beginning of Month	487,869,000	3501
5. Unconsolidated Income/Expense for the Month:		
a. Trading and Investment Account Profit or (Loss)	31,692,000	3951
b. Other Gross Income (Loss)	174,874,000	4212
c. Expenses	187,183,000	4201
d. Federal Income Taxes	7,026,000	4221
6. Net Profit or (Loss) for the Month	12,357,000	4250
7. Other (Exclude Non-Conforming Capital)		
a. Additions to Capital	-	4264
b. Deductions from Capital	-	4274
8. Ownership Equity/Partnership Capital—End of Month	500,226,000	3500
9. Other (Deductions) or Allowable Credits	-	3525
10. Total Capital and Allowable Subordinations	653,706,000	3530
Deductions and/or Charges to Capital		
11. Added Charges Customer and Non-Customer		
a. Security Accounts	6,507,000	3550
a. Commodity Accounts	2,134,000	3560
12. Operational Deductions from Capital (Page 2 Line 8 Col. IV)	2,610,000	3575
13. Non-Allowable Assets (Not Includable Above)	352,010,000	3541
14. Proprietary Charges on Commodities	260,000	3600
15. Other Charges and/or Deductions	1,983,000	3612
16. Total Deductions and/or Charges (Lines 11 thru 15)	365,504 000	3620
17. Net Capital—Before Haircuts on Securities	288,202,000	3640
18. Haircuts on Proprietary Security Positions (Including Contractual Commitments)	123,317,000	3740
19. Net Capital	164,885,000	3750

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART I (OR PART II)

BROKER OR DEALER E. F. Hutton & Company Inc. as of May 31, 1985

FINANCIAL AND OPERATIONAL DATA
Operational Deductions From Capital (Note A)

	I No. of Items	II Debits (Short Value)	III Credits (Long Value)	IV Deductions in Computing Net Capital
1. Money suspense and balancing differences....	5610	$ 5810	$ 6010	$ -0- 6012
2. Security suspense and differences with related money balances L	5620	5820	6020	807,000 6022
S	5625	5825	6025	-0- 6027
3. Market value of short and long security suspense and differences without related money (other than reported in line 4., below)	5630	5830	6030	1,664,000 6032
4. Market value of security record breaks.........	5640	5840	6040	-0- 6042
5. Unresolved reconciling differences with others:				
A. Correspondents and Broker/Dealers L	5650	5850	6050	-0- 6052
S	5655	5855	6055	-0- 6057
B. Depositories..........	5660	5860	6060	-0- 6062
C. Clearing Organizations L	5670	5870	6070	-0- 6072
S	5675	5875	6075	-0- 6077
D. Inter-company Accounts	5680	5880	6080	-0- 6082
E. Bank Accounts and Loans	5690	5890	6090	139,000 6092
F. Other...........	5700	5900	6100	-0- 6102
G. (Offsetting) Items A. through F.	5720	( ) 5920	( ) 6120	▨
TOTAL Line 5.	5730	5930	6130	139,000 6132
6. Commodity Differences	5740	5940	6140	-0- 6142
7. Open transfers and reorganization account items over 40 days not confirmed or verified..........	5760	5960	6160	-0- 6162
8. TOTAL (Lines 1.-7.)	5770	$ 5970	$ 6170	$ 2,610,000 6172
9. Lines 1.-6. resolved subsequent to report date..........	5775	$ 5975	$ 6175	$ 6177
10. Aged Fails—to deliver	636 5780	$ 13,290 5980	$ 13,624 6180	$ 1,266,000 6182
—to receive	300 5785	$ 10,083 5985	$ 10,462 6185	$ 451,000 6187
		(Omit 000's)	(Omit 000's)	(Omit Pennies)

NOTE A—This section must be completed as follows:

1. All member organizations must complete column IV, lines 1. through 8. and 10., reporting deductions from capital as of the report date whether resolved subsequently or not (see instructions relative to each line item).
2. a. Columns I, II and III of lines 1. through 8. and 10. must be completed when a Part II filing is required.
   b. Columns I, II and III of lines 1. through 8. must be completed with a Part I filing, only if the total deduction on line 8. column IV equals or exceeds 25% of excess net capital as of the prior month end reporting date. All columns of line 10. require completion.
3. A response to line 9., cols. I through IV and the "Potential Operational Charges Not Deducted From Capital" schedule on p. 3 are required only if:
   a. the parameters cited in 2.b. above exist; and
   b. the total deduction, line 8. column IV, for the current month exceeds the total deductions for the prior month by 50% or more.
4. All columns and line items (1. through 10.) must be answered if required. If respondent has nothing to report enter -0-.

. . . .

Other Operational Data (Items 1., 2. and 3. below require an answer)

Item 1. Have the accounts enumerated on lines 5.A. through F. above been reconciled with statements received from others within 35 days for lines 5.A through D. and 65 days for items 5.E. and F. prior to the report date and have all reconciling differences been appropriately comprehended in the computation of net capital at the report date? If this has not been done in all respects, answer No.

Yes X 5600
No 5601

Item 2. Do the respondent's books reflect a concentrated position (See instruction) in commodities? If Yes report the totals ($000 omitted) in accordance with the specific instructions; If No answer -0- for:

A. Firm Trading and Investment Accounts
B. Customers' and Non-Customers' and Other Accounts

A. -0- 5602
B. -0- 5603

Item 3. Does respondent have any planned operational or organizational changes? (Answer Yes or No based on specific instructions.)

Yes 5604
No X 5605

FORM X-17A-5

4/81

FOCUS REPORT

(Financial and Operational Combined Uniform Single Report)

PART I OR PART II

☒ 10 ☐ 11

(Read instructions before preparing Form)

This report is being filed pursuant to (Check Applicable Block(s)):

1) Rule 17a-5(a) ☐ 16
2) Rule 17a-5(b) ☐ 17
3) Rule 17a-11 ☐ 18
4) Special request by designated examining authority ☐ 19
5) Other ☐ 26

AME OF BROKER-DEALER: E.F. Hutton & Company Inc. 13

SEC FILE NO. 14

FOR FIRM I.D. NO.: 13-1937069 15

DDRESS OF PRINCIPAL PLACE OF BUSINESS (Do not use P.O. Box No.)

One Battery Park Plaza 20
(No. and Street)

New York 21 New York 22 10004 23
(City) (State) (Zip)

FOR PERIOD BEGINNING (MM/DD/YY): April 1 1985 24

AND ENDING (MM/DD/YY): April 30 1985 25

AME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Michael P. Castellano 30 (212) 742-3546 31
(Area Code—Telephone No.)

AME(S) OF SUBSIDIARIES OR AFFILIATES CONSOLIDATED IN THIS REPORT URSUANT TO APPENDIX C OF RULE 15C3-1		CHECK IF GUARANTEED		CHECK IF FLOW THROUGH	
E.F. Hutton International Inc.	32	X	50		33
	34		51		35
	36		52		37
	38		53		39

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Dated the 23rd day of May 19 85

Manual Signatures of:

1) ______________________
Principal Executive Officer or Managing Partner

2) ______________________
Principal Financial Officer or Partner

3) ______________________
Principal Operations Officer or Partner

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FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. HUTTON - [illegible] C N2 [13]

STATEMENT OF FINANCIAL CONDITION

As of (MM/DD/YY) APRIL 30 1985 [20]
SEC FILE NO. ____ [14]

Consolidated ☒ [198]
Unconsolidated ☐ [199]

ASSETS

	Allowable	Nonallowable	Total
1. Cash	$ 40 592 000 [200]		$ 40 592 000 [750]
2. Cash segregated in compliance with federal and other regulations	102 063 000 [210]		102 063 000 [760]
3. Receivable from brokers or dealers and clearing organizations:			
A. Failed to deliver:			
1. Includable in "Formula for Reserve Requirements"	44 228 000 [220]		
2. Other	32 023 000 [230]		76 251 000 [770]
B. Securities borrowed:			
1. Includable in "Formula for Reserve Requirements"	100 619 000 [240]		
2. Other	872 344 000 [250]		972 963 000 [780]
C. Omnibus accounts:			
1. Includable in "Formula for Reserve Requirements"	-0- [260]		
2. Other	4 593 000 [270]		4 593 000 [790]
D. Clearing organizations:			
1. Includable in "Formula for Reserve Requirements"	6 747 000 [280]		
2. Other	42 479 000 [290]		49 226 000 [800]
E. Other	154 395 000 [300]	$ -0- [550]	154 395 000 [810]
4. Receivables from customers:			
A. Securities accounts:			
1. Cash and fully secured accounts	2 083 364 000 [310]		
2. Partly secured accounts	148 000 [320]	38 000 [560]	
3. Unsecured accounts		11 449 000 [570]	
B. Commodity accounts	64 795 000 [330]	28 520 000 [580]	
C. Allowance for doubtful accounts	(-0-) [335]	(27 176 000) [590]	2 161 131 000 [820]
5. Receivables from non-customers:			
A. Cash and fully secured accounts	14 522 000 [340]		
B. Partly secured and unsecured accounts	-0- [350]	-0- [600]	14 522 000 [830]
6. Securities purchased under agreements to resell	5 468 985 000 [360]	-0- [605]	5 468 985 000 [840]
7. Securities and spot commodities owned, at market value:			
A. Bankers acceptances, certificates of deposit and commercial paper	1 069 271 000 [370]		
B. U.S. and Canadian government obligations	1 161 995 000 [380]		
C. State and municipal government obligations	34 960 000 [390]		
D. Corporate obligations	423 083 000 [400]		

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc as of April 30 1985

STATEMENT OF FINANCIAL CONDITION

ASSETS

		Allowable		Nonallowable		Total	
E. Stocks and warrants		$ 433 994 000	410				
F. Options		16 708 000	420				
G. Arbitrage		– 0 –	422				
H. Other securities		75 347 000	424				
I. Spot commodities		27 543 000	430			$ 3 546 903 000	850
8. Securities owned not readily marketable:							
A. At Cost	$ – 0 – [130]						
B. At estimated fair value		– 0 –	440	$ – 0 –	610	– 0 –	860
9. Other investments not readily marketable:							
A. At Cost	$ 2 090 000 [140]						
B. At estimated fair value		– 0 –	450	1 779 000	620	1 779 000	870
10. Securities borrowed under subordination agreements and partners' individual and capital securities accounts, at market value:							
A. Exempted securities	$ – 0 – [150]						
B. Other	$ – 0 – [160]	– 0 –	460	– 0 –	630	– 0 –	880
11. Secured demand notes-market value of collateral:							
A. Exempted securities	$ – 0 – [170]						
B. Other	$ – 0 – [180]	– 0 –	470	– 0 –	640	– 0 –	890
12. Memberships in exchanges:							
A. Owned, at market value	$ [190]						
B. Owned at cost				5 161 000	650		
C. Contributed for use of company, at market value				– 0 –	660	5 161 000	900
13. Investment in and receivables from affiliates, subsidiaries and associated partnerships		– 0 –	480	4 453 000	670	4 453 000	910
14. Property, furniture, equipment, leasehold improvements and rights under lease agreements: At cost (net of accumulated depreciation and amortization)		– 0 –	490	163 441 000	680	163 441 000	920
15. Other Assets:							
A. Dividends and interest receivable		7 086 000	500	4 630 000	690		
B. Free shipments		4 824 000	510	978 000	700		
C. Loans and advances		– –	520	39 191 000	710		
D. Miscellaneous		107 352 000	530	197 696 000	720	293 249 000	930
16. TOTAL ASSETS		$ 12 707 855 000	540	$ 354 160 000	740	$ 13 062 015 000	940

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc as of April 30, 1985

STATEMENT OF FINANCIAL CONDITION

LIABILITIES AND OWNERSHIP EQUITY

Liabilities	A.I. Liabilities *	Non-A.I. Liabilities *	Total
17. Bank loans payable:			
A. Includable in "Formula for Reserve Requirements"	$ [1030]	$ [1240]	$ 97 365 000 [1460]
B. Other	[1040]	[1250]	632 985 000 [1470]
18. Securities sold under repurchase agreements		[1260]	5 938 099 000 [1480]
19. Payable to brokers or dealers and clearing organizations:			
A. Failed to receive:			
1. Includable in "Formula for Reserve Requirements"	[1050]	[1270]	8 384 000 [1490]
2. Other	[1060]	[1280]	138 218 000 [1500]
B. Securities loaned:			
1. Includable in "Formula for Reserve Requirements"	[1070]		394 367 000 [1510]
2. Other	[1080]	[1290]	408 432 000 [1520]
C. Omnibus accounts:			
1. Includable in "Formula for Reserve Requirements"	[1090]		- 0 - [1530]
2. Other	[1095]	[1300]	354 000 [1540]
D. Clearing organizations:			
1. Includable in "Formula for Reserve Requirements"	[1100]		6 666 000 [1550]
2. Other	[1105]	[1310]	13 285 000 [1560]
E. Other	[1110]	[1320]	43 486 000 [1570]
20. Payable to customers:			
A. Securities accounts - including free credits of $ 592 464 000 [950]	[1120]		1 285 993 000 [1580]
B. Commodities accounts	[1130]	[1330]	155 449 000 [1590]
21. Payable to non customers:			
A. Securities accounts	[1140]	[1340]	5 534 000 [1600]
B. Commodities accounts	[1150]	[1350]	3 000 [1610]
22. Securities sold not yet purchased at market value - including arbitrage of $ 0 [960]		[1360]	2 121 307 000 [1620]
23. Accounts payable and accrued liabilities and expenses:			
A. Drafts payable	[1160]		672 000 [1630]
B. Accounts payable	[1170]		82 919 000 [1640]
C. Income taxes payable	[1180]		55 770 000 [1650]
D. Deferred income taxes		[1370]	- 0 - [1660]
E. Accrued expenses and other liabilities	[1190]		898 152 000 [1670]
F. Other	[1200]	[1380]	40 661 000 [1680]

OMIT PENNIES

*Brokers or Dealers electing the alternative net capital requirement method need not complete these columns.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. Hutton & Company, Inc as of April 30, 1985

STATEMENT OF FINANCIAL CONDITION

LIABILITIES AND OWNERSHIP EQUITY (continued)

Liabilities	A.I. Liabilities *	Non-A.I. Liabilities *	Total
24. Notes and mortgages payable			
A. Unsecured	$ [1210]		$ - 0 - [1690]
B. Secured	[1211]	$ [1390]	- 0 - [1700]
25. Liabilities subordinated to claims of general creditors:			
A. Cash borrowings		[1400]	151 090 000 [1710]
1. from outsiders $ 16000 000 [970]			
2. Includes equity subordination (15c3-1 (d)) of $ [980]			
B. Securities borrowings, at market value; from outsiders $ - 0 - [990]		[1410]	- 0 - [1720]
C. Pursuant to secured demand note collateral agreements;		[1420]	- 0 - [1730]
1. from outsiders $ - 0 - [1000]			
2. Includes equity subordination (15c3-1 (d)) of $ - 0 - [1010]			
D. Exchange memberships contributed for use of company at market value		[1430]	- 0 - [1740]
E. Accounts and other borrowings not qualified for net capital purposes	[1220]	[1440]	2798 000 [1750]
26 TOTAL LIABILITIES	$ [1230]	$ [1450]	$ 12 574 146 000 [1760]

Ownership Equity

27. Sole proprietorship	$ [1770]
28. Partnership- limited partners $ [1020]	[1780]
29. Corporation	
A. Preferred stock	- 0 - [1791]
B. Common stock	2 000 [1792]
C. Additional paid-in capital	95 914 000 [1793]
D. Retained earnings	391 953 000 [1794]
E. Total	487 869 000 [1795]
F. Less capital stock in treasury	(- 0 -) [1796]
TOTAL OWNERSHIP EQUITY	$ 487 869 000 [1800]
TOTAL LIABILITIES AND OWNERSHIP EQUITY	$ 13 062 015 000 [1810]

OMIT PENNIES

*Brokers or Dealers electing the alternative net capital requirement method need not complete these columns.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. Hutton + Company Inc as of April 30, 1985

COMPUTATION OF NET CAPITAL

1. Total ownership equity (from Statement of Financial Condition – Item 1800)					$ 487 869 000	3480
2. Deduct: Ownership equity not allowable for net capital					(– 0 –)	3490
3. Total ownership equity qualified for net capital					487 869 000	3500
4. Add:						
A. Liabilities subordinated to claims of general creditors allowable in computation of net capital					151 090 000	3520
B. Other (deductions) or allowable credits (List)					– 0 –	3525
5. Total capital and allowable subordinated liabilities					$ 638 959 000	3530
6. Deductions and/or charges:						
A. Total non-allowable assets from Statement of Financial Condition (Notes B and C)			$ 354 160 000	3540		
1. Additional charges for customers' and non-customers' security accounts			9 253 000	3550		
2. Additional charges for customers' and non-customers' commodity accounts			2 473 000	3560		
B. Aged fail-to-deliver:			3 151 000	3570		
1. Number of items	628	3450				
C. Aged short security differences-less reserve of	$ – 0 –	3460	858 000	3580		
number of items		3470				
D. Secured demand note deficiency			– 0 –	3590		
E. Commodity futures contracts and spot commodities – proprietary capital charges			705 000	3600		
F. Other deductions and/or charges			1 371 000	3610		
G. Deductions for accounts carried under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x)				3615		
H. Total deductions and/or charges					(371 871 000)	3620
7. Other additions and/or allowable credits (List)					—	3630
8. Net Capital before haircuts on securities positions					$ 269 088 000	3640
9. Haircuts on securities: (computed, where applicable, pursuant to 15c3-1 (f)):						
A. Contractual securities commitments			2 225 000	3660		
B. Subordinated securities borrowings			– 0 –	3670		
C. Trading and investment securities:						
1. Bankers' acceptances, certificates of deposit and commercial paper			4 305 000	3680		
2. U.S. and Canadian government obligations			10 373 000	3690		
3. State and municipal government obligations			14 225 000	3700		
4. Corporate obligations			34 921 000	3710		
5. Stocks and warrants			25 206 000	3720		
6. Options			4 851 000	3730		
7. Arbitrage			– 0 –	3732		
8. Other securities			7 545 000	3734		
D. Undue concentration			– 0 –	3650		
E. Other (list) WIV PS Acct			24 000	3736	(102 675 000)	3740
10. Net Capital					$ 166 413 000	3750

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. HUTTON + COMPANY INC **as of** APRIL 30, 1985

COMPUTATION OF BASIC NET CAPITAL REQUIREMENT

Part A

11. Minimum net capital required (6-2/3% of line 19)	$	3756
12. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)	$	3758
13. Net capital requirement (greater of line 11 or 12)	$	3760
14. Excess net capital (line 10 less 13)	$	3770
15. Excess net capital at 1000% (line 10 less 10% of line 19)	$	3780

COMPUTATION OF AGGREGATE INDEBTEDNESS

16. Total A.I. liabilities from Statement of Financial Condition			$	3790
17. Add:				
A. Drafts for immediate credit	$	3800		
B. Market value of securities borrowed for which no equivalent value is paid or credited	$	3810		
C. Other unrecorded amounts (List)	$	3820	$	3830
18. Deduct: Adjustment based on deposits in Special Reserve Bank Accounts (15c3-1 (c) (1) (vii))			$	3838
19. Total aggregate indebtedness			$	3840
20. Percentage of aggregate indebtedness to net capital (line 19 ÷ by line 10)			%	3850
21. Percentage of Aggregate Indebtedness to net capital *after* anticipated capital withdrawals (line 19 ÷ by line 10 less Item 4880 page 11)			%	3853

COMPUTATION OF ALTERNATE NET CAPITAL REQUIREMENT

Part B

22. 4% 2 of combined aggregate debit items as shown in Formula for Reserve Requirements pursuant to Rule 15c3-3 prepared as of the date of the net capital computation including both brokers or dealers and consolidated subsidiaries' debits	$ 36547 000	3870
23. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)	$ 36573 000	3880
24. Net capital requirement (greater of line 22 or 23)	$ 36573 000	3760
25. Excess net capital (line 10 less 24)	$ 129840 000	3910
26. Percentage of Net Capital to Aggregate Debits (line 10 ÷ by line 17 page 8)	% 9.11	3851
27. Percentage of Net Capital, *after* anticipated capital withdrawals, to Aggregate Debits (line 10 less Item 4880 page 11 ÷ by line 17 page 8)	% 7 88	3854
28. Net capital in excess of the greater of:		
A. 5% of combined aggregate debit items or $120,000	$ 93267 000	3920
B. 7% 5 of combined aggregate debit items or $120,000	$ 74980 000	3930

OTHER RATIOS

Part C

29. Percentage of debt to debt-equity total computed in accordance with Rule 15c3-1 (d)	% 2365	3860
30. Options deductions/Net Capital ratio (1000% test) total deductions exclusive of liquidating equity under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x) ÷ Net Capital	%	3852

NOTES:

(A) The minimum net capital requirement should be computed by adding the minimum dollar net capital requirement of the reporting broker dealer and, for each subsidiary to be consolidated, the greater of:
1. Minimum dollar net capital requirement, or
2. 6-2/3% of aggregate indebtedness or 4% of aggregate debits if alternative method is used.

(B) Do not deduct the value of securities borrowed under subordination agreements or secured demand notes covered by subordination agreements not in satisfactory form and the market values of memberships in exchanges contributed for use of company (contra to item 1740) and partners' securities which were included in non-allowable assets.

(C) For reports filed pursuant to paragraph (d) of Rule 17a-5, respondent should provide a list of material non-allowable assets.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. Hutton + Company Inc as of April 30, 1985

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS
FOR BROKER-DEALERS UNDER RULE 15c3-3
(See Rule 15c3-3, Exhibit A and Related Notes)

CREDIT BALANCES

1. Free credit balances and other credit balances in customers' security accounts (see Note A, Exhibit A, Rule 15c3-3) .... $ 807 224 000 [4340]
2. Monies borrowed collateralized by securities carried for the accounts of customers (see Note B) .... – 0 – [4350]
3. Monies payable against customers' securities loaned (see Note C) .... 381,849,000 [4360]
4. Customers' securities failed to receive (see Note D) .... 106 611 000 [4370]
5. Credit balances in firm accounts which are attributable to principal sales to customers .... 151582 000 [4380]
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days .... 18 000 [4390]
7. **Market value of short security count differences over 30 calendar days old .... 19 000 [4400]
8. **Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days .... 1208 000 [4410]
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days .... 4932 000 [4420]
10. Other (List) .... – 0 – [4425]
11. TOTAL CREDITS .... $ 1,452,643,000 [4430]

DEBIT BALANCES

12. **Debit balances in customers' cash and margin accounts excluding unsecured accounts and accounts doubtful of collection net of deductions pursuant to Note E, Exhibit A, Rule 15c3-3 .... $ 1545546 000 [4440]
13. Securities borrowed to effectuate short sales by customers and securities borrowed to make delivery on customers' securities failed to deliver .... 100619 000 [4450]
14. Failed to deliver of customers' securities not older than 30 calendar days .... 181246 000 [4460]
15. Margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in customer accounts (See Note F) .... – 0 – [4465]
16. Other (List) .... – 0 – [4469]
17. **Aggregate debit items .... $ 1827411 000 [4470]
18. **less 3% (for alternative method only — see Rule 15c3-1 (f) (5) (i)) .... (54 822 000) [4471]
19. **TOTAL 15c3-3 DEBITS .... $ 1772,589 000 [4472]

RESERVE COMPUTATION

20. Excess of total debits over total credits (line 17 less line 11) .... $ 319,946,000 [4480]
21. Excess of total credits over total debits (line 11 less line 17) .... [4490]
22. If computation permitted on a monthly basis, enter 105% of excess of total credits over total debits .... [4500]
23. Amount held on deposit in "Reserve Bank Account(s)", including value of qualified securities, at end of reporting period .... [4510]
24. Amount of deposit (or withdrawal) including $ [4515] value of qualified securities .... [4520]
25. New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including $ [4525] value of qualified securities .... $ [4530]
26. Date of deposit (MMDDYY) .... [4540]

OMIT PENNIES

FREQUENCY OF COMPUTATION

27. Daily [4332] Weekly ✓ [4333] Monthly [4334]

**In the event the Net Capital Requirement is computed under the alternative method, this "Reserve Formula" shall be prepared in accordance with the requirements of paragraph (f) of Rule 15c3-1.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. Hutton & Company Inc as of APR - 30, 1985

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS
FOR BROKER-DEALERS UNDER RULE 15c3-3 (continued)

EXEMPTIVE PROVISIONS

25. If an exemption from Rule 15c3-3 is claimed, identify below the section upon which such exemption is based (check one only)

A. (k) (1)—$2,500 capital category as per Rule 15c3-1 .... ☐ 4550

B. (k) (2)(A)—"Special Account for the Exclusive Benefit of customers" maintained .... ☐ 4560

C. (k) (2)(B)—All customer transactions cleared through another broker-dealer on a fully disclosed basis. Name of clearing firm ☐ 4335 ☐ 4570

D. (k) (3)—Exempted by order of the Commission .... ☐ 4580

Information for Possession or Control Requirements Under Rule 15c3-3

State the market valuation and the number of items of:

1. Customers' fully paid securities and excess margin securities not in the respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frames specified under Rule 15c3-3. Notes A and B .... $ — 0 — 4586

A. Number of items .... — 0 — 4587

2. Customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of the report date, excluding items arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3. Notes B, C and D .... $ ☐ 4588

A. Number of items .... ☐ 4589

OMIT PENNIES

3. The system and procedures utilized in complying with the requirement to maintain physical possession or control of customers' fully paid and excess margin securities have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 15c3-3 .... Yes X 4584 No ☐ 4585

NOTES

A—Do not include in item one customers' fully paid and excess margin securities required by Rule 15c 3-3 to be in possession or control but for which no action was required by the respondent as of the report date or required action was taken by respondent within the time frames specified under Rule 15c3-3.

B—State separately in response to items one and two whether the securities reported in response thereto were subsequently reduced to possession or control by the respondent.

C—Be sure to include in item two only items not arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3.

D—Item two must be responded to only with report which is filed as of the date selected for the broker's or dealer's annual audit of financial statements, whether or not such date is the end of a calendar quarter. The response to item two should be filed within 60 calendar days after such date, rather than with the remainder of this report. This information may be required on a more frequent basis by the Commission or the designated examining authority in accordance with Rule 17a-5(a)(2)(iv).

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. Hutton & Company Inc. as of [illegible]

SCHEDULE OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION

CUSTOMERS' REGULATED COMMODITY FUTURES ACCOUNTS

SEGREGATION REQUIREMENTS

1. Net ledger balance		
a. Cash	$ 99 352 000	7010
b. Securities (at market)	236 090 000	7020
2. Net unrealized profit (loss) in open futures contracts	5 252 000	7030
3. Net equity (Deficit) (Total of 1 - plus or minus 2)	340 694 000	7040
4. Add: accounts liquidating to a deficit and accounts with debit balances with no open trades	9 631 000	7050
5. Amount required to be segregated (Total of 3 & 4	$ 352 325 000	7060

FUNDS ON DEPOSIT IN SEGREGATION

6. Deposited in segregated funds bank accounts:		
a. Cash	101 504 000	7070
b. Securities representing investments of customers' funds (at market)	-0-	7080
c. Securities held for customers in lieu of cash margins (at market)	236 090 000	7090
7. Margins on deposit with clearing organizations of contract markets:		
a. Cash	11 534 000	7100
b. Securities representing investments of customers' funds (at market)	16 055 000	7110
c. Securities held for customers in lieu of cash margins (at market)	-0-	7120
8. Settlement due from (to) contract market clearing organization	(4 913 000)	7130
9. Net equities with other FCMs	4 000	7140
10. Segregated funds on hand:		
a. Cash	-0-	7150
b. Securities representing investments of customers' funds (at market)	-0-	7160
c. Securities held for customers in lieu of cash margins (at market)	-0-	7170
11. Total amount in segregation (Total of 6 through 10)	$ 360 274 000	718
12. Excess funds (insufficiency) in segregation (11 minus 5)	$ 7 949 000	719

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. HUTTON & COMPANY INC as of APRIL 30 1985

Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, (as defined below), which have not been deducted in the computation of Net Capital.

	Type of Proposed withdrawal or Accrual See below for code to enter		Name of Lender or Contributor		Insider or Outsider? (In or Out)		Amount to be Withdrawn (cash amount and/or Net Capital Value of Securities)		(MMDDYY) Withdrawal or Maturity Date		Expect to Renew (yes or no)	
*	2	4600	FIRST INTERSTATE BANK	4601	OUT	4602	$ 1000000	4603	6/30/85	4604	NO	4605
*	2	4610	FIRST INTERSTATE BANK	4611	OUT	4612	1000000	4613	9/30/85	4614	NO	4615
*		4620		4621		4622		4623		4624		4625
*		4630		4631		4632		4633		4634		4635
*		4640		4641		4642		4643		4644		4645
*		4650		4651		4652		4653		4654		4655
*		4660		4661		4662		4663		4664		4665
*		4670		4671		4672		4673		4674		4675
*		4680		4681		4682		4683		4684		4685
*	5	4690		4691		4692	20 350 000	4693		4694		4695

TOTAL $ 22350000 4699*

OMIT PENNIES

*To agree with the total on Recap (Item No. 4880)

Instructions: Detail listing must include the total of items maturing during the six month period following the report date, regardless of whether or not the capital contribution is expected to be renewed. The schedule must also include proposed capital withdrawals scheduled within the six month period following the report date including the proposed redemption of stock and payments of liabilities secured by fixed assets (which are considered allowable assets in the capital computation pursuant to Rule 15c3-1(c)(2)(iv)), which could be required by the lender on demand or in less than six months.

WITHDRAWAL CODE:	DESCRIPTION
1.	Equity Capital
2.	Subordinated Liabilities
3.	Accruals
4.	15c3-1(c)(2)(iv) Liabilities
5	AGGREGATE DEBIT EXTENDED TO CUSTOMERS IN [illegible] [illegible] [illegible]

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
Capital Withdrawals
PART II

BROKER OR DEALER E.F. HUTTON + Co. Inc. For the period (MMDDYY) from APRIL, 985 to NOV. 30 1985

RECAP

Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, which have not been deducted in the computation of net capital.

1. **Equity Capital**		
A. Partnership Capital:		
1. General Partners	$	4700
2. Limited		4710
3. Undistributed Profits		4720
4. Other (describe below)		4730
5. Sole Proprietorship		4735
B. Corporation Capital:		
1. Common Stock		4740
2. Preferred Stock		4750
3. Retained Earnings (Dividends and Other)		4760
4. Other (describe below)		4770
2. **Subordinated Liabilities**		
A. Secured Demand Notes		4780
B. Cash Subordinations		4790
C. Debentures	2000 000	4800
D. Other (describe below)		4810
3. **Other Anticipated Withdrawals**		
A. Bonuses		4820
B. Voluntary Contributions to Pension or Profit Sharing Plans		4860
C. Other (describe below)	20350 000	4870
Total	$ 20350 000	4880

4. **Description of Other**

SC -ANTICIPATE CREDIT EXTENDED TO CUSTOMERS
on RESTRICTED EQUITIES

STATEMENT OF CHANGES IN OWNERSHIP EQUITY
(SOLE PROPRIETORSHIP, PARTNERSHIP OR CORPORATION)

1. Balance, beginning of period			$ 480 278 000	4240
A. Net income (loss)			7591 000	4250
B. Additions (Includes non-conforming capital of	$	4262)		4260
C. Deductions (Includes non-conforming capital of	$	4272)		4270
2. Balance, end of period (From item 1800)			$ 487869 000	4290

STATEMENT OF CHANGES IN LIABILITIES SUBORDINATED TO CLAIMS OF GENERAL CREDITORS

3. Balance, beginning of period	$ 149843 000	4300
A. Increases	2679 000	4310
B. Decreases	(1432 000)	4320
4. Balance, end of period (From item 3520)	$ 151 090 000	4330

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II (OR PART IIA)

BROKER OR DEALER E. F. Hutton + Company Inc as of 4-30-85

FINANCIAL AND OPERATIONAL DATA
Operational Deductions From Capital (Note A)

	I No. of Items		II Debits (Short Value)		III Credits (Long Value)		IV Deductions in Computing Net Capital	
1. Money suspense and balancing differences		5610	$	5810	$	6010	$ -0-	6012
2. Security suspense and differences with related money balances L		5620		5820		6020	659 000	6022
S		5625		5825		6025	-0-	6027
3. Market value of short and long security suspense and differences without related money (other than reported in line 4., below)		5630		5830		6030	858 000	6032
4. Market value of security record breaks		5640		5840		6040	-0-	6042
5. Unresolved reconciling differences with others:								
A. Correspondents and Broker/Dealers L		5650		5850		6050	-0-	6052
S		5655		5855		6055	-0-	6057
B. Depositories		5660		5860		6060	-0-	6062
C. Clearing Organizations L		5670		5870		6070	-0-	6072
S		5675		5875		6075	-0-	6077
D. Inter-company Accounts		5680		5880		6080	-0-	6082
E. Bank Accounts and Loans		5690		5890		6090	102 000	6092
F. Other		5700		5900		6100	—	6102
G. (Offsetting) Items A. through F.		5720	( )	5920	( )	6120	▨	
TOTAL Line 5.		5730		5930		6130	102 000	6132
6. Commodity Differences		5740		5940		6140	1619 000	6142
7. Open transfers and reorganization account items over 40 days not confirmed or verified		5760		5960		6160		6162
8. TOTAL (Lines 1.-7.)		5770	$	5970	$	6170	$ 1619 000	6172
9. Lines 1.-6. resolved subsequent to report date		5775	$	5975	$	6175	$	6177
10. Aged Fails—to deliver	638	5780	$ 22 593	5980	$ 33 768	6180	$ 3151 000	6182
—to receive	351	5785	$ 9275	5985	$ 9323	6185	$ 193 000	6187
			(Omit 000's)		(Omit 000's)		(Omit Pennies)	

NOTE A—This section must be completed as follows:

1. All member organizations must complete column IV, lines 1. through 8. and 10., reporting deductions from capital as of the report date whether resolved subsequently or not (see instructions relative to each line item).
2. a. Columns I, II and III of lines 1. through 8. and 10. must be completed when a Part II filing is required.
   b. Columns I, II and III of lines 1. through 8. must be completed with a Part I filing, only if the total deduction on line 8. column IV equals or exceeds 25% of excess net capital as of the prior month end reporting date. All columns of line 10. require completion.
3. A response to line 9., cols. I through IV and the "Potential Operational Charges Not Deducted From Capital" schedule on p. 3 are required only if:
   a. The parameters cited in 2.b. above exist; and
   b. The total deduction, line 8., column IV, for the current month exceeds the total deductions for the prior month by 50% or more.
4. All columns and line items (1. through 10.) must be answered if required. If respondent has nothing to report enter -0-.

• •

Other Operational Data (Items 1., 2. and 3. below require an answer)

Item 1. Have the accounts enumerated on lines 5.A. through F. above been reconciled with statements received from others within 35 days for lines 5.A through D. and 65 days for lines 5.E. and F. prior to the report date and have all reconciling differences been appropriately comprehended in the computation of net capital at the report date? If this has not been done in all respects, answer No.

Yes ✓
No

Item 2. Do the respondent's books reflect a concentrated position (See Instruction) in commodities? If Yes report the totals (000 omitted) in accordance with the specific instructions; if No answer -0- for:
A. Firm Trading and Investment Accounts
B. Customers' and Non-Customers' and Other Accounts

A.
B.

Item 3. Does respondent have any planned operational or organizational changes? (Answer Yes or No based on specific instructions.)

Yes
No

FORM X-17A-5

4/81

FOCUS REPORT

(Financial and Operational Combined Uniform Single Report)

PART I OR PART II

☒ 10 ☐ 11

(Read instructions before preparing Form)

This report is being filed pursuant to (Check Applicable Block(s)):

1) Rule 17a-5(a) ☒ 16
2) Rule 17a-5(b) ☐ 17
3) Rule 17a-11 ☐ 18
4) Special request by designated examining authority ☐ 19
5) Other ☐ 26

NAME OF BROKER-DEALER: E. F. Hutton & Company Inc. [13]

SEC FILE NO. [14]

FOR FIRM ID. NO.: 13-1937069 [15]

ADDRESS OF PRINCIPAL PLACE OF BUSINESS (Do not use P.O. Box No.)

One Battery Park Plaza [20]
(No. and Street)

New York [21] (City)
New York [22] (State)
10004 [23] (Zip)

FOR PERIOD BEGINNING (MM/DD/YY): April 1, 1985 [24]

AND ENDING (MM/DD/YY): April 30, 1985 [25]

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Michael P. Castellano [30]

(Area Code—Telephone No.) (212) 742-3546 [31]

NAME(S) OF SUBSIDIARIES OR AFFILIATES CONSOLIDATED IN THIS REPORT PURSUANT TO APPENDIX C OF RULE 15C3-1		CHECK IF GUARANTEED		CHECK IF FLOW THROUGH	
E. F. Hutton International Inc.	32	X	50		33
	34		51		35
	36		52		37
	38		53		39

DOES RESPONDENT CARRY ITS OWN CUSTOMER ACCOUNTS? YES ☒ 40 NO ☐ 41

DOES RESPONDENT CLEAR TRANSACTIONS? YES ☒ 43 NO ☐ 44

CHECK HERE IF RESPONDENT IS FILING AN AUDITED REPORT ☐ 42

EXECUTION:

The registrant/broker or dealer submitting this Form and its attachments and the person(s) by whom it is executed represent hereby that all information contained therein is true, correct and complete. It is understood that all required items, statements, and schedules are considered integral parts of this Form and that the submission of any amendment represents that all unamended items, statements and schedules remain true, correct and complete as previously submitted. See general instructions for reporting contractural and contingent liabilities.

Dated the 23rd day of May 19 85

Manual Signatures of:

1) ______________________
Principal Executive Officer or Managing Partner

2) Norman Epstein
Principal Financial Officer or Partner

3) ______________________
Principal Operations Officer or Partner

ATTENTION— Intentional misstatements or omissions of facts constitute Federal Criminal Violations. (See 18 U.S.C. 1001 and 15 U.S.C. 78f (a))

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT

PART I
FOCUS REPORT

		ITEM
DEALER tton & Company Inc.	N 1 For Current Month	100
	AS OF (MMDDYY) April 30, 1985	99
	SEC FILE NO.	98

	(OMIT PENNIES)	
ated Loan Agreements—Cash	151,090,000	1710
Demand Notes—Face Amount	-	1730
ordinations Allowable for Net Capital	151,090,000	3520
o Equity/Partnership Capital—Beginning of Month	480,278,000	3501
dated Income/Expense for the Month:		
g and Investment Account Profit or (Loss)	23,444,000	3951
Gross Income (Loss)	172,303,000	4212
es	184,106,000	4201
Income Taxes	4,050,000	4221
or (Loss) for the Month	7,591,000	4250
clude Non-Conforming Capital)		
ns to Capital	-	4264
ons from Capital	-	4274
Equity/Partnership Capital—End of Month	487,869,000	3500
ductions) or Allowable Credits	-	3525
tal and Allowable Subordinations	638,959,000	3530
s and/or Charges to Capital		
rges Customer and Non-Customer		
Accounts	9,253,000	3550
dity Accounts	2,473,000	3560
l Deductions from Capital (Page 2 Line 8 Col. IV)	1,619,000	3575
able Assets (Not Includable Above)	354,160,000	3541
Charges on Commodities	705,000	3600
ges and/or Deductions	3,661,000	3612
ctions and/or Charges (Lines 11 thru 15)	371,871,000	3620
—Before Haircuts on Securities	267,088,000	3640
Proprietary Security Positions (Including Contractual Commitments)	100,675,000	3740
	166,413,000	3750
	22,350,000	4880

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART I (OR PART II)

BROKER OR DEALER E. F. Hutton & Company Inc. as of April 30, 1985

FINANCIAL AND OPERATIONAL DATA
Operational Deductions From Capital (Note A)

	I No. of Items		II Debits (Short Value)		III Credits (Long Value)		IV Deductions in Computing Net Capital	
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B. Depositories		5660		5860		6060	-0-	6062
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D. Inter-company Accounts		5680		5880		6080	-0-	6082
E. Bank Accounts and Loans		5690		5890		6090	102,000	6092
F. Other		5700		5900		6100	-0-	6102
G. (Offsetting) Items A. through F.		5720	( )	5920	( )	6120	▨	▨
TOTAL Line 5.		5730		5930		6130	102,000	6132
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—to receive	251	5785	$ 9,275	5985	$ 9,323	6185	$ 193,000	6187
			(Omit 000's)		(Omit 000's)		(Omit Pennies)	

NOTE A—This section must be completed as follows:

1. All member organizations must complete column IV, lines 1. through 8. and 10., reporting deductions from capital as of the report date whether resolved subsequently or not (see instructions relative to each line item).
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   b. Columns I, II and III of lines 1. through 8. must be completed with a Part I filing, only if the total deduction on line 8. column IV equals or exceeds 25% of excess net capital as of the prior month end reporting date. All columns of line 10. require completion.
3. A response to line 9., cols. I through IV and the "Potential Operational Charges Not Deducted From Capital" schedule on p. 3 are required only if:
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   b. the total deduction, line 8. column IV, for the current month exceeds the total deductions for the prior month by 50% or more.
4. All columns and line items (1. through 10.) must be answered if required. If respondent has nothing to report enter -0-.

………………………

Other Operational Data (Items 1., 2. and 3. below require an answer)

Item 1. Have the accounts enumerated on lines 5.A. through F. above been reconciled with statements received from others within 35 days for lines 5.A through D. and 65 days for lines 5.E. and F. prior to the report date and have all reconciling differences been appropriately comprehended in the computation of net capital at the report date? If this has not been done in all respects, answer No.

Yes X 5600
No 5601

Item 2. Do the respondent's books reflect a concentrated position (See instruction) in commodities? If Yes report the totals (000 omitted) in accordance with the specific instructions; if No answer -0- for:

A. Firm Trading and Investment Accounts
B. Customers' and Non-Customers' and Other Accounts

A. 0 5602
B. 0 5603

Item 3. Does respondent have any planned operational or organizational changes? (Answer Yes or No based on specific instructions.)

Yes 5604
No X 5605

FORM X-17A-5

4/81

FOCUS REPORT

(Financial and Operational Combined Uniform Single Report)

PART I OR PART II

☐ 10 ☒ 11

(Read instructions before preparing Form)

This report is being filed pursuant to (Check Applicable Block(s)):

1) Rule 17a-5(a) ☒ 16 2) Rule 17a-5(b) ☐ 17 3) Rule 17a-11 ☐ 18

4) Special request by designated examining authority ☐ 19 5) Other ☐ 26

NAME OF BROKER-DEALER E. F. Hutton & Company Inc. 13	SEC FILE NO. 14 FOR FIRM ID. NO. 13-937069 15
ADDRESS OF PRINCIPAL PLACE OF BUSINESS (Do not use P.O. Box No.) One Battery Park Plaza 20 (No. and Street) New York 21 New York 22 10004 23 (City) (State) (Zip)	FOR PERIOD BEGINNING (MM/DD/YY) January 1, 1985 24 AND ENDING (MM/DD/YY) 25 March 31, 1985

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Michael P. Castellano 30

(Area Code—Telephone No.) (212) 742-3546 31

NAME(S) OF SUBSIDIARIES OR AFFILIATES CONSOLIDATED IN THIS REPORT PURSUANT TO APPENDIX C OF RULE 15C3-1		CHECK IF GUARANTEED		CHECK IF FLOW THROUGH
E. F. Hutton International Inc.	32	X	50	33
	34		51	35
	36		52	37
	38		53	39

DOES RESPONDENT CARRY ITS OWN CUSTOMER ACCOUNTS? YES ☒ 40 NO ☐ 41

DOES RESPONDENT CLEAR TRANSACTIONS? YES ☒ 42 NO ☐ 44

CHECK HERE IF RESPONDENT IS FILING AN AUDITED REPORT ☐ 42

EXECUTION:

The registrant/broker or dealer submitting this Form and its attachments and the person(s) by whom it is executed represent hereby that all information contained therein is true, correct and complete. It is understood that all required items, statements, and schedules are considered integral parts of this Form and that the submission of any amendment represents that all unamended items, statements and schedules remain true, correct and complete as previously submitted. See general instructions for reporting contractural and contingent liabilities.

Dated the 24th day of April 19 85

Manual Signatures of:

1) Robert Fomon
Principal Executive Officer or Managing Partner

2)
Principal Financial Officer or Partner

3) Norman Epstein
Principal Operations Officer or Partner

ATTENTION— Intentional misstatements or omissions of facts constitute Federal Criminal Violations. (See 18 U.S.C. 1001 and 15 U.S.C. 78ff (a).)

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER ▼ E. F. Hutton & Company Inc. | N | 2 | [100]

STATEMENT OF FINANCIAL CONDITION

As of (MM/DD/YY) March 31, 1985 [99]

SEC FILE NO. ____________ [98]

Consolidated ☒ [198]
Unconsolidated ☐ [199]

ASSETS

	Allowable		Nonallowable		Total	
1. Cash	▼ $ 45,016,000	200			$ 45,016,000	750
2. Cash segregated in compliance with federal and other regulations	128,583,000	210			128,583,000	760
3. Receivable from brokers or dealers and clearing organizations:						
A. Failed to deliver:						
1. Includable in "Formula for Reserve Requirements"	13,393,000	220				
2. Other	25,070,000	230			38,463,000	770
B. Securities borrowed:						
1. Includable in "Formula for Reserve Requirements"	50,339,000	240				
2. Other	887,610,000	250			937,949,000	780
C. Omnibus accounts:						
1. Includable in "Formula for Reserve Requirements"	-0-	260				
2. Other	▼ 9,655,000	270			9,655,000	790
D. Clearing organizations:						
1. Includable in "Formula for Reserve Requirements"	6,605,000	280				
2. Other	60,638,000	290			67,243,000	800
E. Other	255,846,000	300	$ -0-	550	▼ 255,846,000	810
4. Receivables from customers:						
A. Securities accounts:						
1. Cash and fully secured accounts	1,555,205,000	310				
2. Partly secured accounts	614,000	320	130,000	560		
3. Unsecured accounts			10,427,000	570		
B. Commodity accounts	67,782,000	330	29,574,000	580		
C. Allowance for doubtful accounts	▼ (-0-)	335	(26,805,000)	590	1,636,927,000	820
5. Receivables from non-customers:						
A. Cash and fully secured accounts	12,399,000	340				
B. Partly secured and unsecured accounts	-0-	350	-0-	600	12,399,000	830
6. Securities purchased under agreements to resell	6,260,064,000	360	▼ -0-	605	6,260,064,000	840
7. Securities and spot commodities owned, at market value:						
A. Bankers acceptances, certificates of deposit and commercial paper	736,234,000	370				
B. U.S. and Canadian government obligations	1,753,665,000	380				
C. State and municipal government obligations	420,799,000	390				
D. Corporate obligations	▼ 508,950,000	400				

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PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of March 31, 1985

STATEMENT OF FINANCIAL CONDITION

ASSETS

		Allowable	Nonallowable	Total
E. Stocks and warrants		$ 383,479,000 [410]		
F. Options		26,425,000 [420]		
G. Arbitrage		-0- [422]		
H. Other securities		80,992,000 [424]		
I. Spot commodities		51,392,000 [430]		$ 3,961,936,000 [850]
8. Securities owned not readily marketable:				
A. At Cost	$ -0- [130]			
B. At estimated fair value		-0- [440]	$ -0- [610]	-0- [860]
9. Other investments not readily marketable:				
A. At Cost	$ 2,094,000 [140]			
B. At estimated fair value		-0- [450]	1,783,000 [620]	1,783,000 [870]
10. Securities borrowed under subordination agreements and partners' individual and capital securities accounts, at market value				
A. Exempted securities	$ -0- [150]			
B. Other	$ -0- [160]	-0- [460]	-0- [630]	-0- [880]
11. Secured demand notes-market value of collateral:				
A. Exempted securities	$ -0- [170]			
B. Other	$ -0- [180]	-0- [470]	-0- [640]	-0- [890]
12. Memberships in exchanges:				
A. Owned, at market value	$ 13,600,000 [190]			
B. Owned at cost			5,161,000 [650]	
C. Contributed for use of company, at market value			-0- [660]	5,161,000 [900]
13. Investment in and receivables from affiliates, subsidiaries and associated partnerships		-0- [480]	3,817,000 [670]	3,817,000 [910]
14. Property, furniture, equipment, leasehold improvements and rights under lease agreements: At cost (net of accumulated depreciation and amortization)		-0- [490]	161,256,000 [680]	161,256,000 [920]
15. Other Assets:				
A. Dividends and interest receivable		9,992,000 [500]	5,230,000 [690]	
B. Free shipments		3,593,000 [510]	204,000 [700]	
C. Loans and advances		-0- [520]	32,245,000 [710]	
D. Miscellaneous		120,180,000 [530]	131,662,000 [720]	303,106,000 [930]
16. TOTAL ASSETS		$ 13,474,520,000 [540]	$ 354,684,000 [740]	$ 13,829,204,000 [940]

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STATEMENT OF FINANCIAL CONDITION

LIABILITIES AND OWNERSHIP EQUITY

Liabilities	A.I. Liabilities *	Non-A.I. Liabilities *	Total
17. Bank loans payable:			
A. Includable in "Formula for Reserve Requirements"	$ [1030]	$ [1240]	$ 250,649,000 [1460]
B. Other	[1040]	[1250]	583,700,000 [1470]
18. Securities sold under repurchase agreements		[1260]	6,862,588,000 [1480]
19. Payable to brokers or dealers and clearing organizations:			
A. Failed to receive:			
1. Includable in "Formula for Reserve Requirements"	[1050]	[1270]	18,668,000 [1490]
2. Other	[1060]	[1280]	639,783,000 [1500]
B. Securities loaned:			
1. Includable in "Formula for Reserve Requirements"	[1070]		393,702,000 [1510]
2. Other	[1080]	[1290]	474,395,000 [1520]
C. Omnibus accounts:			
1. Includable in "Formula for Reserve Requirements"	[1090]		-0- [1530]
2. Other	[1095]	[1300]	12,398,000 [1540]
D. Clearing organizations:			
1. Includable in "Formula for Reserve Requirements"	[1100]		6,589,000 [1550]
2. Other	[1105]	[1310]	1,050,000 [1560]
E. Other	[1110]	[1320]	32,564,000 [1570]
20. Payable to customers:			
A. Securities accounts - including free credits of $ 701,277,000 [950]	[1120]		1,000,156,000 [1580]
B. Commodities accounts	[1130]	[1330]	172,886,000 [1590]
21. Payable to non customers:			
A. Securities accounts	[1140]	[1340]	4,084,000 [1600]
B. Commodities accounts	[1150]	[1350]	400,000 [1610]
22. Securities sold not yet purchased at market value - including arbitrage of $ -0- [960]		[1360]	1,715,884,000 [1620]
23. Accounts payable and accrued liabilities and expenses:			
A. Drafts payable	[1160]		630,000 [1630]
B. Accounts payable	[1170]		182,324,000 [1640]
C. Income taxes payable	[1180]		25,471,000 [1650]
D. Deferred income taxes		[1370]	-0- [1660]
E. Accrued expenses and other liabilities	[1190]		782,309,000 [1670]
F. Other	[1200]	[1380]	36,775,000 [1680]

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*Brokers or Dealers electing the alternative net capital requirement method need not complete these columns.

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STATEMENT OF FINANCIAL CONDITION

LIABILITIES AND OWNERSHIP EQUITY (continued)

Liabilities	A.I. Liabilities *	Non-A.I. Liabilities *	Total
24. Notes and mortgages payable:			
A. Unsecured	$ [1210]		$ -0- [1690]
B. Secured	[1211]	$ [1390]	-0- [1700]
25. Liabilities subordinated to claims of general creditors:			
A. Cash borrowings		[1400]	149,843,000 [1710]
1. from outsiders $ 16,000,000 [970]			
2. Includes equity subordination (15c3-1 (d)) of $ -0- [980]			
B. Securities borrowings, at market value; from outsiders $ -0- [990]		[1410]	-0- [1720]
C. Pursuant to secured demand note collateral agreements;		[1420]	-0- [1730]
1. from outsiders $ [1000]			
2. Includes equity subordination (15c3-1 (d)) of $ -0- [1010]			
D. Exchange memberships contributed for use of company at market value		[1430]	-0- [1740]
E. Accounts and other borrowings not qualified for net capital purposes	[1220]	[1440]	2,078,000 [1750]
26. TOTAL LIABILITIES	$ [1230]	$ [1450]	$ 13,348,926,000 [1760]

Ownership Equity

27. Sole proprietorship	$ [1770]
28. Partnership- limited partners $ [1020]	[1780]
29. Corporation:	
A. Preferred stock	[1791]
B. Common stock	2,000 [1792]
C. Additional paid-in capital	95,914,000 [1793]
D. Retained earnings	384,362,000 [1794]
E. Total	480,278,000 [1795]
F. Less capital stock in treasury	(-0-) [1796]
30. TOTAL OWNERSHIP EQUITY	$ 480,278,000 [1800]
31. TOTAL LIABILITIES AND OWNERSHIP EQUITY	$ 13,829,204,000 [1810]

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*Brokers or Dealers electing the alternative net capital requirement method need not complete these columns.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
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BROKER OR DEALER E. F. Hutton & Company Inc. as of March 31, 1985

COMPUTATION OF NET CAPITAL

1. Total ownership equity (from Statement of Financial Condition – Item 1800)					$ 480,278,000	3480
2. Deduct: Ownership equity not allowable for net capital					(-0-)	3490
3. Total ownership equity qualified for net capital					480,278,000	3500
4. Add:						
A. Liabilities subordinated to claims of general creditors allowable in computation of net capital					149,843,000	3520
B. Other (deductions) or allowable credits (List)					-0-	3525
5. Total capital and allowable subordinated liabilities					$ 630,121,000	3530
6. Deductions and/or charges:						
A. Total non-allowable assets from Statement of Financial Condition (Note B and C)			$ 354,684,000	3540		
1. Additional charges for customers' and non-customers' security accounts			8,108,000	3550		
2. Additional charges for customers' and non-customers' commodity accounts			1,835,000	3560		
B. Aged fail-to-deliver:			1,106,000	3570		
1. Number of items	611	3450				
C. Aged short security differences-less reserve of	$ -0-	3460	1,105,000	3580		
number of items	164	3470				
D. Secured demand note deficiency			-0-	3590		
E. Commodity futures contracts and spot commodities – proprietary capital charges			472,000	3600		
F. Other deductions and/or charges			1,843,000	3610		
G. Deductions for accounts carried under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x)			-0-	3615		
H. Total deductions and/or charges					(369,153,000)	3620
7. Other additions and/or allowable credits (List)						3630
8. Net Capital before haircuts on securities positions					$ 260,968,000	3640
9. Haircuts on securities: (computed, where applicable, pursuant to 15c3-1 (f)):						
A. Contractual securities commitments			3,394,000	3660		
B. Subordinated securities borrowings			-0-	3670		
C. Trading and investment securities:						
1. Bankers' acceptances, certificates of deposit and commercial paper			1,812,000	3680		
2. U.S. and Canadian government obligations			10,374,000	3690		
3. State and municipal government obligations			19,209,000	3700		
4. Corporate obligations			42,239,000	3710		
5. Stocks and warrants			18,776,000	3720		
6. Options			9,871,000	3730		
7. Arbitrage			-0-	3732		
8. Other securities			6,416,000	3734		
D. Undue concentration			-0-	3650		
E. Other (list)			92,000	3736	(112,183,000)	3740
10. Net Capital					$ 148,785,000	3750

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FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of March 31, 1985

COMPUTATION OF BASIC NET CAPITAL REQUIREMENT

Part A

11. Minimum net capital required (6-2/3% of line 19)				$		3756
12. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)				$		3758
13. Net capital requirement (greater of line 11 or 12)				$		3760
14. Excess net capital (line 10 less 13)				$		3770
15. Excess net capital at 1000% (line 10 less 10% of line 19)				$		3780

COMPUTATION OF AGGREGATE INDEBTEDNESS

16. Total A.I. liabilities from Statement of Financial Condition				$		3790
17. Add:						
A. Drafts for immediate credit	$		3800			
B. Market value of securities borrowed for which no equivalent value is paid or credited	$		3810			
C. Other unrecorded amounts (List)	$		3820	$		3830
18. Deduct: Adjustment based on deposits in Special Reserve Bank Accounts (15c3-1 (c) (1) (vii))				$		3838
19. Total aggregate indebtedness				$		3840
20. Percentage of aggregate indebtedness to net capital (line 19 ÷ by line 10)				%		3850
21. Percentage of Aggregate Indebtedness to net capital *after* anticipated capital withdrawals (line 19 ÷ by line 10 less Item 4880 page 11)				%		3853

COMPUTATION OF ALTERNATE NET CAPITAL REQUIREMENT

Part B

22. 2% of combined aggregate debit items as shown in Formula for Reserve Requirements pursuant to Rule 15c3-3 prepared as of the date of the net capital computation including both brokers or dealers and consolidated subsidiaries' debits	$	34,984,000	3870
23. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)	$		
24. Net capital requirement (greater of line 22 or 23)	$	35,009,000	3880
25. Excess net capital (line 10 less 24)	$	35,009,000	3760
	$	113,776,000	3910
26. Percentage of Net Capital to Aggregate Debits (line 10 ÷ by line 17 page 8)	%	8.51	3851
27. Percentage of Net Capital, *after* anticipated capital withdrawals, to Aggregate Debits (line 10 less Item 4880 page 11 ÷ by line 17 page 8)	%	7.27	3854
28. Net capital in excess of the greater of:			
A 4% of combined aggregate debit items or $120,000	$	78,766,000	3920
B 5% of combined aggregate debit items or $120,000	$	61,262,000	3930

OTHER RATIOS

Part C

29. Percentage of debt to debt-equity total computed in accordance with Rule 15c3-1 (d)	%	23.78	3860
30. Options deductions/Net Capital ratio (1000% test) total deductions exclusive of liquidating equity under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x) ÷ Net Capital	%		3852

NOTES:

(A) The minimum net capital requirement should be computed by adding the minimum dollar net capital requirement of the reporting broker dealer and, for each subsidiary to be consolidated, the greater of:
1. Minimum dollar net capital requirement, or
2. 6-2/3% of aggregate indebtedness or 4% of aggregate debits if alternative method is used.

(B) Do not deduct the value of securities borrowed under subordination agreements or secured demand notes covered by subordination agreements not in satisfactory form and the market values of memberships in exchanges contributed for use of company (contra to item 1740) and partners' securities which were included in non-allowable assets.

(C) For reports filed pursuant to paragraph (d) of Rule 17a-5, respondent should provide a list of material non-allowable assets.

PART II—FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT

BROKER OR DEALER E. F. Hutton & Company Inc.	For the period (MMDDYY) from 1/01/85 [3932] to 3/31/85 [3933] Number of months included in this statement 3 [3931]

REVENUE

STATEMENT OF INCOME (LOSS)

1. Commissions:				
a. Commissions on transactions in listed equity securities executed on an exchange			$ 85,120,000	3935
b. Commissions on transactions in exchange listed equity securities executed over-the-counter			-0-	3937
c. Commissions on listed option transactions			19,187,000	3938
d. All other securities commissions			11,616,000	3939
e. Total securities commissions			115,923,000	3940
2. Gains or losses on firm securities trading accounts				
a. From market making in over-the-counter equity securities			16,325,000	3941
i. Includes gains or (losses) OTC market making in exchange listed equity securities	-0-	3943		
b. From trading in debt securities			81,252,000	3944
c. From market making in options on a national securities exchange			-0-	3945
d. From all other trading			(87,000)	3949
e. Total gains or (losses)			97,490,000	3950
3. Gains or losses on firm securities investment accounts				
a. Includes realized gains (losses)	417,000	4235		
b. Includes unrealized gains (losses)	530,000	4236		
c. Total realized and unrealized gains (losses)			947,000	3952
4. Profits or (losses) from underwriting and selling groups			35,706,000	3955
a. Includes underwriting income from corporate equity securities	10,009,000	4237		
5. Margin interest			31,751,000	3960
6. Revenue from sale of investment company shares			22,075,000	3970
7. Fees for account supervision, investment advisory and administrative services			16,313,000	3975
8. Revenue from research services			-	3980
9. Commodities revenue			33,134,000	3990
10. Other revenue related to securities business			181,526,000	3985
11. Other revenue			15,138,000	3995
12. Total revenue			$ 550,003,000	4030
EXPENSES				
13. Registered representatives' compensation			$ 153,836,000	4110
14. Clerical and administrative employees' expenses			45,501,000	4040
15. Salaries and other employment costs for general partners, and voting stockholder officers			19,116,000	4120
a. Includes interest credited to General and Limited Partners capital accounts	-0-	4130		
16. Floor brokerage paid to certain brokers (see definition)			2,140,000	4055
17. Commissions and clearance paid to all other brokers (see definition)			6,231,000	4145
18. Clearance paid to non-brokers (see definition)			4,309,000	4135
19. Communications			34,341,000	4060
20. Occupancy and equipment costs			30,496,000	4080
21. Promotional costs			12,623,000	4150
22. Interest expense			184,613,000	4075
a. Includes interest on accounts subject to subordination agreements	2,886,000	4070		
23. Losses in error account and bad debts			4,089,000	4170
24. Data processing costs (including service bureau service charges)			4,029,000	4186
25. Non-recurring charges			-0-	4190
26. Regulatory fees and expenses			1,238,000	4195
27. Other expenses			23,754,000	4100
28. Total expenses			$ 526,316,000	4200
NET INCOME				
29. Income (loss) before Federal income taxes and items below (Item 12 less Item 28)			$ 23,687,000	4210
30. Provision for Federal income taxes (for parent only)			6,834,000	4220
31. Equity in earnings (losses) of unconsolidated subsidiaries not included above			(9,000)	4222
a. After Federal income taxes of	-0-	4238		
32. Extraordinary gains (losses)			-0-	4224
a. After Federal income taxes of	-0-	4239		
33. Cumulative effect of changes in accounting principles			-0-	4225
34. Net income (loss) after Federal income taxes and extraordinary items			$ 16,844,000	4230
MONTHLY INCOME				
35. Income (current month only) before provision for Federal income taxes and extraordinary items			$ 1,145,000	4211

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
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BROKER OR DEALER E. F. Hutton & Company Inc. as of March 31, 1985

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS FOR BROKER-DEALERS UNDER RULE 15c3-3
(See Rule 15c3-3, Exhibit A and Related Notes)

CREDIT BALANCES

1. Free credit balances and other credit balances in customers' security accounts (see Note A, Exhibit A, Rule 15c3-3)	$1,042,873,000	4340		
2. Monies borrowed collateralized by securities carried for the accounts of customers (see Note B)	-0-	4350		
3. Monies payable against customers' securities loaned (see Note C)	393,702,000	4360		
4. Customers' securities failed to receive (see Note D)	110,628,000	4370		
5. Credit balances in firm accounts which are attributable to principal sales to customers	196,430,000	4380		
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days	23,000	4390		
7. **Market value of short security count differences over 30 calendar days old	29,000	4400		
8. **Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days	1,857,000	4410		
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days	6,120,000	4420		
10. Other (List)	-0-	4425		
11. TOTAL CREDITS			$ 1,751,662,000	443

DEBIT BALANCES

12. **Debit balances in customers' cash and margin accounts excluding unsecured accounts and accounts doubtful of collection net of deductions pursuant to Note E, Exhibit A, Rule 15c3-3	$1,450,448,000	4440		
13. Securities borrowed to effectuate short sales by customers and securities borrowed to make delivery on customers' securities failed to deliver	50,339,000	4450		
14. Failed to deliver of customers' securities not older than 30 calendar days	248,431,000	4460		
15. Margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in customer accounts (See Note F)	-0-	4465		
16. Other (List)	-0-	4469		
17. **Aggregate debit items			$ 1,749,218,000	447
18. **less 3% (for alternative method only — see Rule 15c3-1 (f) (5) (i))			(52,477,000)	447
19. **TOTAL 15c3-3 DEBITS			$1,696,741,000	447

RESERVE COMPUTATION

20. Excess of total debits over total credits (line 19 less line 11)	$	44
21. Excess of total credits over total debits (line 11 less line 19)	54,921,000	44
22. If computation permitted on a monthly basis, enter 105% of excess of total credits over total debits		45
23. Amount held on deposit in "Reserve Bank Account(s)", including value of qualified securities, at end of reporting period	20,000,000	45
24. Amount of deposit (or withdrawal) including $ ____ 4515 value of qualified securities	80,000,000	452
25. New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including $ ____ 4525 value of qualified securities	$ 100,000,000	45
26. Date of deposit (MMDDYY)	04-02-85	454

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FREQUENCY OF COMPUTATION

27. Daily ____ 4332 Weekly X 4333 Monthly ____ 4334

**In the event the Net Capital Requirement is computed under the alternative method, this "Reserve Formula" shall be prepared in accordance with the requirements of paragraph (f) of Rule 15c3-1

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COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS FOR BROKER-DEALERS UNDER RULE 15c3-3 (continued)

EXEMPTIVE PROVISIONS

25. If an exemption from Rule 15c3-3 is claimed, identify below the section upon which such exemption is based (check one only)

A. (k) (1)—$2,500 capital category as per Rule 15c3-1 .... ______ 4550

B. (k) (2)(A)—"Special Account for the Exclusive Benefit of customers" maintained .... ______ 4560

C. (k) (2)(B)—All customer transactions cleared through another broker-dealer on a fully disclosed basis. Name of clearing firm ______ 4335 ______ 4570

D. (k) (3)—Exempted by order of the Commission .... ______ 4580

Information for Possession or Control Requirements Under Rule 15c3-3

State the market valuation and the number of items of:

1. Customers' fully paid securities and excess margin securities not in the respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frames specified under Rule 15c3-3. Notes A and B .... $ -0- 4586

   A. Number of items .... -0- 4587

2. Customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of the report date, excluding items arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3. Notes B, C and D .... $ ______ 4588

   A. Number of items .... ______ 4589

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3. The system and procedures utilized in complying with the requirement to maintain physical possession or control of customers' fully paid and excess margin securities have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 15c3-3 .... Yes X 4584 No ______ 4585

NOTES

A—Do not include in item one customers' fully paid and excess margin securities required by Rule 15c 3-3 to be in possession or control but for which no action was required by the respondent as of the report date or required action was taken by respondent within the time frames specified under Rule 15c3-3.

B—State separately in response to items one and two whether the securities reported in response thereto were subsequently reduced to possession or control by the respondent.

C—Be sure to include in item two only items not arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3.

D—Item two must be responded to only with report which is filed as of the date selected for the broker's or dealer's annual audit of financial statements, whether or not such date is the end of a calendar quarter. The response to item two should be filed within 60 calendar days after such date, rather than with the remainder of this report. This information may be required on a more frequent basis by the Commission or the designated examining authority in accordance with Rule 17a-5(a)(2)(iv).

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
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BROKER OR DEALER E. F. Hutton & Company Inc. as of March 31, 1985

SCHEDULE OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION

CUSTOMERS' REGULATED COMMODITY FUTURES ACCOUNTS

SEGREGATION REQUIREMENTS

1. Net ledger balance		
a. Cash	$ 112,843,000	7010
b. Securities (at market)	246,205,000	7020
2. Net unrealized profit (loss) in open futures contracts	2,794,000	7030
3. Net equity (Deficit) (Total of 1 - plus or minus 2)	361,842,000	7040
4. Add: accounts liquidating to a deficit and accounts with debit balances with no open trades	28,816,000	7050
5. Amount required to be segregated (Total of 3 & 4	$ 390,658,000	7060

FUNDS ON DEPOSIT IN SEGREGATION

6. Deposited in segregated funds bank accounts:		
a. Cash	108,507,000	7070
b. Securities representing investments of customers' funds (at market)	–	7080
c. Securities held for customers in lieu of cash margins (at market)	246,205,000	7090
7. Margins on deposit with clearing organizations of contract markets:		
a. Cash	22,732,000	7100
b. Securities representing investments of customers' funds (at market)	20,939,000	7110
c. Securities held for customers in lieu of cash margins (at market)	–	7120
8. Settlement due from (to) contract market clearing organization	2,143,000	7130
9. Net equities with other FCMs	17,000	7140
10. Segregated funds on hand:		
a. Cash	–	7150
b. Securities representing investments of customers' funds (at market)	–	7160
c. Securities held for customers in lieu of cash margins (at market)	–	7170
11. Total amount in segregation (Total of 6 through 10)	$ 400,543,000	7180
12. Excess funds (Insufficiency) in segregation (11 minus 5)	$ 9,885,000	7190

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of March 31, 1985

Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, (as defined below), which have not been deducted in the computation of Net Capital.

	Type of Proposed withdrawal or Accrual See below for code to enter		Name of Lender or Contributor		Insider or Outsider? (In or Out)		Amount to be Withdrawn (cash amount and/or Net Capital Value of Securities)		(MMDDYY) Withdrawal or Maturity Date		Expect to Renew (yes or no)	
Y	2	4600	First Interstate Bank	4601	Out	4602	$ 1,000,000	4603	6/30/85	4604	No	4605
Y	2	4610	First Interstate Bank	4611	Out	4612	1,000,000	4613	9/30/85	4614	No	4615
Y		4620		4621		4622		4623		4624		4625
Y		4630		4631		4632		4633		4634		4635
Y		4640		4641		4642		4643		4644		4645
Y		4650		4651		4652		4653		4654		4655
Y		4660		4661		4662		4663		4664		4665
Y		4670		4671		4672		4673		4674		4675
Y		4680		4681		4682		4683		4684		4685
Y	5	4690		4691		4692	19,657,000	4693		4694		4695

TOTAL $ 21,657,000 4699*

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*To agree with the total on Recap (Item No. 4880)

Instructions: Detail listing must include the total of items maturing during the six month period following the report date, regardless of whether or not the capital contribution is expected to be renewed. The schedule must also include proposed capital withdrawals scheduled within the six month period following the report date including the proposed redemption of stock and payments of liabilities secured by fixed assets (which are considered allowable assets in the capital computation pursuant to Rule 15c3-1(c)(2)(iv)), which could be required by the lender on demand or in less than six months.

WITHDRAWAL CODE:	DESCRIPTION
1.	Equity Capital
2.	Subordinated Liabilities
3.	Accruals
4.	15c3-1(c)(2)(iv) Liabilities
5.	Aggregate credit extended to customers on restricted securities.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
Capital Withdrawals
PART II

BROKER OR DEALER
E. F. Hutton & Company Inc.

For the period (MMDDYY) from January 1, 1985 to March 31, 1985

RECAP

Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, which have not been deducted in the computation of net capital.

1. **Equity Capital**		
A. Partnership Capital:		
1. General Partners	$	4700
2. Limited		4710
3. Undistributed Profits		4720
4. Other (describe below)		4730
5. Sole Proprietorship		4735
B. Corporation Capital:		
1. Common Stock		4740
2. Preferred Stock		4750
3. Retained Earnings (Dividends and Other)		4760
4. Other (describe below)		4770
2. **Subordinated Liabilities**		
A. Secured Demand Notes		4780
B. Cash Subordinations		4790
C. Debentures	2,000,000	4800
D. Other (describe below)		4810
3. **Other Anticipated Withdrawals**		
A. Bonuses		4820
B. Voluntary Contributions to Pension or Profit Sharing Plans		4860
C. Other (describe below)	19,657,000	4870
Total	$ 21,657,000	4880

4. **Description of Other**

3.c. Aggregate credit extended to customers on restricted securities.

STATEMENT OF CHANGES IN OWNERSHIP EQUITY
(SOLE PROPRIETORSHIP, PARTNERSHIP OR CORPORATION)

1. Balance, beginning of period			$ 463,434,000	4240
A. Net income (loss)			16,844,000	4250
B. Additions (includes non-conforming capital of	$	4262	) -0-	4260
C. Deductions (includes non-conforming capital of	$	4272	) -0-	4270
2. Balance, end of period (From item 1800)			$ 480,278,000	4290

STATEMENT OF CHANGES IN LIABILITIES SUBORDINATED TO CLAIMS OF GENERAL CREDITORS

3. Balance, beginning of period	$ 143,983,000	4300
A. Increases	22,239,000	4310
B. Decreases	(16,379,000)	4320
4. Balance, end of period (From item 3520)	$ 149,843,000	4330

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of March 31, 1985

FINANCIAL AND OPERATIONAL DATA

		Valuation		Number	
1.	Month end total number of stock record breaks unresolved over three business days				
	A. breaks long	$	4890		4900
	B. breaks short	$	4910		4920

2. Is the firm in compliance with Rule 17a-13 regarding periodic count and verification of securities positions and locations at least once in each calendar quarter? (Check one) Yes ☒ 4930 No ☐ 4940

A) If response is negative attach explanation of steps being taken to comply with Rule 17a-13.

3.	Personnel employed at end of reporting period:		
	A. Income producing personnel	7,065	4950
	B. Non-income producing personnel (all other)	8,829	4960
	C. Total	15,894	4970
4.	Actual number of tickets executed during current month of reporting period	1,035,789	4980
5.	Number of corrected customer confirmations mailed after settlement date	7,651	4990

		No. of Items		Debit (Short Value)		No. of Items		Credit (Long Value)	
6.	Money differences		5000	$	5010		5020	$	5030
7.	Security suspense accounts		5040	$	5050		5060	$	5070
8.	Security difference accounts		5080	$	5090		5100	$	5110
9.	Commodity suspense accounts		5120	$	5130		5140	$	5150
10.	Open transactions with correspondents, other brokers, clearing organizations, depositories and interoffice and intercompany accounts which could result in a charge-unresolved amounts over 30 calendar days		5160	$	5170		5180	$	5190
11.	Bank account reconciliations-unresolved amounts over 30 calendar days		5200	$	5210		5220	$	5230
12.	Open transfers over 40 calendar days, not confirmed		5240	$	5250		5260	$	5270
13.	Transactions in reorganization accounts-over 60 calendar days		5280	$	5290		5300	$	5310
14.	Total		5320	$	5330		5340	$	5350

		No. of Items		Ledger Amount		Market Value	
15.	Failed to deliver 11 business days or longer (21 business day or longer in the case of Municipal Securities)		5360	$	5361	$	5362
16.	Failed to receive 11 business days or longer (21 business day or longer in the case of Municipal Securities)		5363	$	5364	$	5365

17.	Security concentrations (See instructions in Part I)		
	A. Proprietary positions	$ -0-	5370
	B. Customers' accounts under Rule 15c3-3	$ -0-	5374
18.	Total of personal capital borrowings due within six months	$ -0-	5378
19.	Maximum haircuts on underwriting commitments during the period	$14,873,000	5380
20.	Planned capital expenditures for business expansion during next six months	$ 8,300,000	5382
21.	Liabilities of other individuals or organizations guaranteed by respondent	$ -0-	5384
22.	Lease and rentals payable within one year	$66,491,000	5386
23.	Aggregate lease and rental commitments payable for entire term of the lease		
	A. Gross	$667,225,000	5388
	B. Net	$648,543,000	5390

OMIT PENNIES

Note: See Financial and Operational Data, page 2, for Item 1 and Items 6 through 16.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART I (OR PART II)

BROKER OR DEALER E. F. Hutton & Company Inc.

as of March 31, 1985

FINANCIAL AND OPERATIONAL DATA
Operational Deductions From Capital (Note A)

	I No. of Items	II Debits (Short Value)	III Credits (Long Value)	IV Deductions In Computing Net Capital
1. Money suspense and balancing differences	-0-	$ -0-	$ -0-	$ -0-
2. Security suspense and differences with related money balances L	94	-0-	12,468	1,033,000
S	12	94	-0-	-0-
3. Market value of short and long security suspense and differences without related money (other than reported in line 4., below)	164	1,897	-0-	1,105,000
4. Market value of security record breaks	-0-	-0-	-0-	-0-
5. Unresolved reconciling differences with others:				
A. Correspondents and Broker/Dealers L	-0-	-0-	-0-	-0-
S	-0-	-0-	-0-	-0-
B. Depositories	-0-	-0-	-0-	-0-
C. Clearing Organizations L	-0-	-0-	-0-	-0-
S	-0-	-0-	-0-	-0-
D. Inter-company Accounts	-0-	-0-	-0-	-0-
E. Bank Accounts and Loans	53	175	186	157,000
F. Other	-0-	-0-	-0-	-0-
G. (Offsetting) Items A. through F.	(47)	(18)	(18)	▨
TOTAL Line 5.	6	157	168	157,000
6. Commodity Differences	-0-	-0-	-0-	-0-
7. Open transfers and reorganization account items over 40 days not confirmed or verified	528	6,120	-0-	-0-
8. TOTAL (Lines 1.-7.)	804	$ 8,268	$ 12,636	$ 2,295,000
9. Lines 1.-6. resolved subsequent to report date		$	$	$
10. Aged Fails—to deliver	611	$ 9,769	$ 9,788	$ 1,106,000
—to receive	207	$ 8,806	$ 7,937	$ 115,000
		(Omit 000's)	(Omit 000's)	(Omit Pennies)

NOTE A—This section must be completed as follows:

1. All member organizations must complete column IV, lines 1. through 8. and 10., reporting deductions from capital as of the report date whether resolved subsequently or not (see instructions relative to each line item).
2. a. Columns I, II and III of lines 1. through 8. and 10. must be completed when a Part II filing is required.
   b. Columns I, II and III of lines 1. through 8. must be completed with a Part I filing, only if the total deduction on line 8. column IV equals or exceeds 25% of excess net capital as of the prior month end reporting date. All columns of line 10. require completion.
3. A response to line 9., cols. I through IV and the "Potential Operational Charges Not Deducted From Capital" schedule on p. 3 are required only if:
   a. the parameters cited in 2.b. above exist; and
   b. the total deduction, line 8. column IV, for the current month exceeds the total deductions for the prior month by 50% or more.
4. All columns and line items (1. through 10.) must be answered if required. If respondent has nothing to report enter -0-.

……

Other Operational Data (Items 1., 2. and 3. below require an answer)

Item 1. Have the accounts enumerated on lines 5.A. through F. above been reconciled with statements received from others within 35 days for lines 5.A through D. and 65 days for lines 5.E. and F. prior to the report date and have all reconciling differences been appropriately comprehended in the computation of net capital at the report date? If this has not been done in all respects, answer No.

Yes X
No ____

Item 2. Do the respondent's books reflect a concentrated position (See instructions) in commodities? If Yes report the totals (000 omitted) in accordance with the specific instructions; if No answer -0- for:
A. Firm Trading and Investment Accounts
B. Customers' and Non-Customers' and Other Accounts

A. -0-
B. -0-

Item 3. Does respondent have any planned operational or organizational changes? (Answer Yes or No based on specific instructions.)

Yes ____
No X

EF Hutton & Company Inc.
Member New York Stock Exchange

EFHutton

One Battery Park Plaza
New York, NY 10004
Telephone: (212) 742-5000

SUBORDINATED LIABILITIES

March 31, 1985

First Interstate Bank* - Due 1985-1986	$ 5,000,000.00
Royal Bank of Canada - Due 1985	11,000,000.00
Subordinated Deferred Compensation	133,843,000.00
Total Subordinated Liabilities (FOCUS Item 1710)	$ 149,843,000.00

* Formerly United California Bank

FINANCIAL OPERATIONAL COMBINED UNIF SINGLE REPORT
PART II

BROKER OR DEALER E.F. Hutton + Company Inc N2 [100]

STATEMENT OF FINANCIAL CONDITION

As of (MM/DD/YY) February 28 1985 [98]

SEC FILE NO. ______ [99]

Consolidated ☒ [198]
Unconsolidated ☐ [199]

ASSETS

	Allowable		Nonallowable		Total	
1. Cash	$ 58704 000	200			$ 58704 000	750
2. Cash segregated in compliance with federal and other regulations	247 151 000	210			247151 000	760
3. Receivable from brokers or dealers and clearing organizations:						
A. Failed to deliver:						
1. Includable in "Formula for Reserve Requirements"	14 750 000	220				
2. Other	49 691 000	230			64 441 000	770
B. Securities borrowed:						
1. Includable in "Formula for Reserve Requirements"	44 318 000	240				
2. Other	883 160 000	250			927 478 000	780
C. Omnibus accounts:						
1. Includable in "Formula for Reserve Requirements"	- 0 -	260				
2. Other	56 314 000	270			56 314 000	790
D. Clearing organizations:						
1. Includable in "Formula for Reserve Requirements"	6 000	280				
2. Other	65 704 000	290			65 710 000	800
E. Other	345 476 000	300	$ - 0 -	550	345 476 000	810
4. Receivables from customers:						
A. Securities accounts:						
1. Cash and fully secured accounts	1719579 000	310				
2. Partly secured accounts	321 000	320	53 000	560		
3. Unsecured accounts			11 310 000	570		
B. Commodity accounts	62633 000	330	27 960 000	580		
C. Allowance for doubtful accounts	(- 0 -)	335	(37332 000)	590	1784514 000	820
5. Receivables from non-customers:						
A. Cash and fully secured accounts	13 575 000	340				
B. Partly secured and unsecured accounts	- 0 -	350	- 0 -	600	13 575 000	830
6. Securities purchased under agreements to resell	5589 098 000	360	- 0 -	605	5589 098 000	840
7. Securities and spot commodities owned, at market value:						
A. Bankers acceptances, certificates of deposit and commercial paper	1537 303 000	370				
B. U.S. and Canadian government obligations	2447993 000	380				
C. State and municipal government obligations	24 035 000	390				
D. Corporate obligations	389302 000	400				

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FINANCIAL A OPERATIONAL COMBINED UNIFO: SINGLE REPORT
PART II

BROKER OR DEALER E.F. Hutton & Company Inc. as of February 28, 1985

STATEMENT OF FINANCIAL CONDITION

ASSETS

	Allowable		Nonallowable		Total	
E. Stocks and warrants	$ 307844 000	410				
F. Options	27559 000	420				
G. Arbitrage	-	422				
H. Other securities	76857 000	424				
I. Spot commodities	-	430			$ 508913 000	850
8. Securities owned not readily marketable:						
A. At Cost $ -0- [130]						
B. At estimated fair value	-0-	440	$ -0-	610	-0-	860
9. Other investments not readily marketable:						
A. At Cost $ 2 090 000 [140]						
B. At estimated fair value	-0-	450	1 779 000	620	1 779 000	870
10. Securities borrowed under subordination agreements and partners' individual and capital securities accounts, at market value:						
A. Exempted securities $ -0- [150]						
B. Other $ -0- [160]	-0-	460	-0-	630	-0-	880
11. Secured demand notes-market value of collateral:						
A. Exempted securities $ -0- [170]						
B. Other $ -0- [180]	-0-	470	-0-	640	-0-	890
12. Memberships in exchanges:						
A. Owned, at market value $ [190]						
B. Owned at cost			5 161 000	650		
C. Contributed for use of company, at market value			-0-	660	5 161 000	900
13. Investment in and receivables from affiliates, subsidiaries and associated partnerships	-0-	480	3 506 000	670	3 506 000	910
14. Property, furniture, equipment, leasehold improvements and rights under lease agreements: At cost (net of accumulated depreciation and amortization)	-0-	490	153 493 000	680	153 493 000	920
15. Other Assets:						
A. Dividends and interest receivable	13 418 000	500	7373 000	690		
B. Free shipments	4 890 000	510	223 000	700		
C. Loans and advances	-0-	520	[illegible]	710		
D. Miscellaneous	155 430 000	530	190 634 000	720	384994 000	930
16. TOTAL ASSETS	$ 1035151 000	540	$ 387 155 000	740	$ 1422306 000	940

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F Hutton & Company Inc as of February 28, 1985

STATEMENT OF FINANCIAL CONDITION

LIABILITIES AND OWNERSHIP EQUITY

Liabilities	A.I. Liabilities *	Non-A.I. Liabilities *	Total
17. Bank loans payable:			
A. Includable in "Formula for Reserve Requirements"	$ 1030	$ 1240	$ 160 605 000 1460
B. Other	1040	1250	991 695 000 1470
18. Securities sold under repurchase agreements		1260	7 710 949 000 1480
19. Payable to brokers or dealers and clearing organizations:			
A. Failed to receive:			
1. Includable in "Formula for Reserve Requirements"	1050	1270	32 329 000 1490
2. Other	1060	1280	84 785 000 1500
B. Securities loaned:			
1. Includable in "Formula for Reserve Requirements"	1070		462 997 000 1510
2. Other	1080	1290	453 415 000 1520
C. Omnibus accounts:			
1. Includable in "Formula for Reserve Requirements"	1090		-0- 1530
2. Other	1095	1300	61 496 000 1540
D. Clearing organizations:			
1. Includable in "Formula for Reserve Requirements"	1100		10 628 000 1550
2. Other	1105	1310	7 138 000 1560
E. Other	1110	1320	25 549 000 1570
20. Payable to customers:			
A. Securities accounts - including free credits of $ 590 519 000 950	1120		1 027 782 000 1580
B. Commodities accounts	1130	1330	169 896 000 1590
21. Payable to non customers:			
A. Securities accounts	1140	1340	3 599 000 1600
B. Commodities accounts	1150	1350	48 000 1610
22. Securities sold not yet purchased at market value - including arbitrage of $ -0- 960		1360	1 879 634 000 1620
23. Accounts payable and accrued liabilities and expenses:			
A. Drafts payable	1160		1 333 000 1630
B. Accounts payable	1170		175 303 000 1640
C. Income taxes payable	1180		43 940 000 1650
D. Deferred income taxes		1370	-0- 1660
E. Accrued expenses and other liabilities	1190		682 619 000 1670
F. Other	1200	1380	38 725 000 1680

OMIT PENNIES

*Brokers or Dealers electing the alternative net capital requirement method need not complete these columns.

FINANCIAL A. OPERATIONAL COMBINED UNIFOI SINGLE REPORT
PART II

BROKER OR DEALER E F Hutton & Company Inc. as of February 28 1975

STATEMENT OF FINANCIAL CONDITION

LIABILITIES AND OWNERSHIP EQUITY (continued)

	Liabilities	A.I. Liabilities *	Non-A.I. Liabilities *	Total
24.	Notes and mortgages payable:			
	A. Unsecured	$ 1210		$ 1690
	B. Secured	$ 1211	$ 1390	1700
25.	Liabilities subordinated to claims of general creditors:			
	A. Cash borrowings		1400	153 025 000 1710
	1. from outsiders $ 970			
	2. Includes equity subordination (15c3-1 (d)) of $ 980			
	B. Securities borrowings, at market value: from outsiders $ 990		1410	1720
	C. Pursuant to secured demand note collateral agreements;		1420	$ 1730
	1. from outsiders $ 1000			
	2. Includes equity subordination (15c3-1 (d)) of $ 1010			
	D. Exchange memberships contributed for use of company at market value		$ 1430	1740
	E. Accounts and other borrowings not qualified for net capital purposes	1220	1440	1 373 000 1750
26.	TOTAL LIABILITIES	$ 1230	$ 1450	$ 14174673000 1760

Ownership Equity

27.	Sole proprietorship	$ 1770
28.	Partnership- limited partners $ 1020	1780
29.	Corporation:	
	A. Preferred stock	1791
	B. Common stock	$ 2 000 1792
	C. Additional paid-in capital	95 914 000 1793
	D. Retained earnings	38 717 000 1794
	E. Total	477 633 000 1795
	F. Less capital stock in treasury	( ) 1796
30.	TOTAL OWNERSHIP EQUITY	$ 477 633 000 1800
31.	TOTAL LIABILITIES AND OWNERSHIP EQUITY	$ 1465236000 1810

OMIT PENNIES

*Brokers or Dealers electing the alternative net capital requirement method need not complete these columns.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E F Hutton & Company Inc   as of February 28 1985

COMPUTATION OF NET CAPITAL

1	Total ownership equity (from Statement of Financial Condition – Item 1800)				$ 477633 000	3480
2	Deduct: Ownership equity not allowable for net capital				( )	3490
3	Total ownership equity qualified for net capital				477633 000	3500
4	Add:					
	A. Liabilities subordinated to claims of general creditors allowable in computation of net capital				153 035 000	3520
	B. Other (deductions) or allowable credits (List)					3525
5	Total capital and allowable subordinated liabilities				$ 630 668 000	3530
6	Deductions and/or charges:					
	A. Total non-allowable assets from Statement of Financial Condition (Note B and C)		$ 337155 000	3540		
	1. Additional charges for customers' and non-customers' security accounts		5583 000	3550		
	2. Additional charges for customers' and non-customers' commodity accounts		2167 000	3560		
	B. Aged fail-to-deliver:		3822 000	3570		
	1. Number of items	631 (3450)				
	C. Aged short security differences-less reserve of	$ -0- (3460)	65 000	3580		
	number of items	86 (3470)				
	D. Secured demand note deficiency		-0-	3590		
	E. Commodity futures contracts and spot commodities – proprietary capital charges		3049 000	3600		
	F. Other deductions and/or charges		1422 000	3610		
	G. Deductions for accounts carried under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x)		-0-	3615		
	H. Total deductions and/or charges				(352843 000)	3620
7	Other additions and/or allowable credits (List)					3630
8	Net Capital before haircuts on securities positions				$ 277825 000	3640
9	Haircuts on securities: (computed, where applicable, pursuant to 15c3-1 (f)):					
	A. Contractual securities commitments		5358 000	3660		
	B. Subordinated securities borrowings		-0-	3670		
	C. Trading and investment securities:					
	1. Bankers' acceptances, certificates of deposit and commercial paper		4523 000	3680		
	2. U.S. and Canadian government obligations		7486 000	3690		
	3. State and municipal government obligations		17941 000	3700		
	4. Corporate obligations		32339 000	3710		
	5. Stocks and warrants		30285 000	3720		
	6. Options		11312 000	3730		
	7. Arbitrage		-0-	3732		
	8. Other securities		8825 000	3734		
	D. Undue concentration		-0-	3650		
	E. Other (list)		48 000	3736	(108117 000)	3740
10	Net Capital				$ 169708 000	3750

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FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. Hutton & Company Inc as of February 28, 197[illegible]

COMPUTATION OF BASIC NET CAPITAL REQUIREMENT

Part A

11.	Minimum net capital required (6-2/3% of line 19)	$	3756
12.	Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)	$	3758
13.	Net capital requirement (greater of line 11 or 12)	$	3760
14.	Excess net capital (line 10 less 13)	$	3770
15.	Excess net capital at 1000% (line 10 less 10% of line 19)	$	3780

COMPUTATION OF AGGREGATE INDEBTEDNESS

16.	Total A.I. liabilities from Statement of Financial Condition			$	3790
17.	Add:				
	A. Drafts for immediate credit	$	3800		
	B. Market value of securities borrowed for which no equivalent value is paid or credited	$	3810		
	C. Other unrecorded amounts (List)	$	3820	$	3830
18.	Deduct: Adjustment based on deposits in Special Reserve Bank Accounts (15c3-1 (c) (1) (vii))			$	3838
19.	Total aggregate indebtedness			$	3840
20.	Percentage of aggregate indebtedness to net capital (line 19 ÷ by line 10)			%	3850
21.	Percentage of Aggregate Indebtedness to net capital *after* anticipated capital withdrawals (line 19 ÷ by line 10 less Item 4880 page 11)			%	3853

COMPUTATION OF ALTERNATE NET CAPITAL REQUIREMENT

Part B

22.	4% 2 of combined aggregate debit items as shown in Formula for Reserve Requirements pursuant to Rule 15c3-3 prepared as of the date of the net capital computation including both brokers or dealers and consolidated subsidiaries' debits	$ 37606 000	3870
23.	Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)	$ 37631 000	3880
24.	Net capital requirement (greater of line 22 or 23)	$ 37631 000	3760
25.	Excess net capital (line 10 less 24)	$ 132 077 000	3910
26.	Percentage of Net Capital to Aggregate Debits (line 10 ÷ by line 17 page 8)	% 9.03	3851
27.	Percentage of Net Capital, *after* anticipated capital withdrawals, to Aggregate Debits (line 10 less Item 4880 page 11 ÷ by line 17 page 8)	% 7.87	3854
28.	Net capital in excess of the greater of:		
	A. 6% of combined aggregate debit items or $120,000	$ 94446 000	3920
	B. 3% 6 of combined aggregate debit items or $120,000	$ 75631000	3930

OTHER RATIOS

Part C

29.	Percentage of debt to debt-equity total computed in accordance with Rule 15c3-1 (d)	% 34.37	3860
30.	Options deductions/Net Capital ratio (1000% test) total deductions exclusive of liquidating equity under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x) ÷ Net Capital	%	3852

NOTES:

(A) The minimum net capital requirement should be computed by adding the minimum dollar net capital requirement of the reporting broker dealer and, for each subsidiary to be consolidated, the greater of:
1. Minimum dollar net capital requirement, or
2. 6-2/3% of aggregate indebtedness or 4% of aggregate debits if alternative method is used.

(B) Do not deduct the value of securities borrowed under subordination agreements or secured demand notes covered by subordination agreements not in satisfactory form and the market values of memberships in exchanges contributed for use of company (contra to item 1740) and partners' securities which were included in non-allowable assets.

(C) For reports filed pursuant to paragraph (d) of Rule 17a-5, respondent should provide a list of material non-allowable assets.

FiNANCIAL # OPERATIONAL COMBINED UNIFOR INGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of February 28, 1985

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS FOR BROKER-DEALERS UNDER RULE 15c3-3
(See Rule 15c3-3, Exhibit A and Related Notes)

CREDIT BALANCES

1. Free credit balances and other credit balances in customers' security accounts (see Note A, Exhibit A, Rule 15c3-3)	$962,[illegible]9,000	4340		
2. Monies borrowed collateralized by securities carried for the accounts of customers (see Note B)	–	4350		
3. Monies payable against customers' securities loaned (see Note C)	462,937,000	4360		
4. Customers' securities failed to receive (see Note D)	125,572,000	4370		
5. Credit balances in firm accounts which are attributable to principal sales to customers	236,182,000	4380		
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days	37,000	4390		
7. **Market value of short security count differences over 30 calendar days old	1,000	4400		
8. **Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days	627,000	4410		
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days	1,867,000	4420		
10. Other (List)	–	4425		
11. TOTAL CREDITS			$1,790,741,000	4430

DEBIT BALANCES

12. **Debit balances in customers' cash and margin accounts excluding unsecured accounts and accounts doubtful of collection net of deductions pursuant to Note E, Exhibit A, Rule 15c3-3	$1,610,286,000	4440		
13. Securities borrowed to effectuate short sales by customers and securities borrowed to make delivery on customers' securities failed to deliver	44,318,000	4450		
14. Failed to deliver of customers' securities not older than 30 calendar days	225,703,000	4460		
15. Margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in customer accounts (See Note F)	–	4465		
16. Other (List)	–	4469		
17. **Aggregate debit items			$1,880,307,000	4470
18. **less 3% (for alternative method only — see Rule 15c3-1 (f) (5) (ii))			(56,409,000)	4471
19. **TOTAL 15c3-3 DEBITS			$1,823,898,000	4472

RESERVE COMPUTATION

20. Excess of total debits over total credits (line 17 less line 11)	$33,157,000	4480
21. Excess of total credits over total debits (line 11 less line 17)		4490
22. If computation permitted on a monthly basis, enter 105% of excess of total credits over total debits		4500
23. Amount held on deposit in "Reserve Bank Account(s)", including value of qualified securities, at end of reporting period	140,000,000	4510
24. Amount of deposit (or withdrawal) including $ ______ 4515 value of qualified securities		4520
25. New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including $ ______ 4525 value of qualified securities	$	4530
26. Date of deposit (MMDDYY)	2/26/85	4540

OMIT PENNIES

FREQUENCY OF COMPUTATION

27. Daily ______ 4332 Weekly ✓ 4333 Monthly ______ 4334

**In the event the Net Capital Requirement is computed under the alternative method, this "Reserve Formula" shall be prepared in accordance with the requirements of paragraph (f) of Rule 15c3-1

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of February 28, 1985

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS
FOR BROKER-DEALERS UNDER RULE 15c3-3 (continued)

EXEMPTIVE PROVISIONS

25. If an exemption from Rule 15c3-3 is claimed, identify below the section upon which such exemption is based (check one only)

A (k) (1)—$2,500 capital category as per Rule 15c3-1 .... ______ 4550

B (k) (2)(A)—"Special Account for the Exclusive Benefit of customers" maintained .... ______ 4560

C (k) (2)(B)—All customer transactions cleared through another broker-dealer on a fully disclosed basis. Name of clearing firm ______ 4335 ______ 4570

D (k) (3)—Exempted by order of the Commission .... ______ 4580

Information for Possession or Control Requirements Under Rule 15c3-3

State the market valuation and the number of items of:

1. Customers' fully paid securities and excess margin securities not in the respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frames specified under Rule 15c3-3. Notes A and B .... $ ______ 4586

   A. Number of items .... ______ 4587

2. Customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of the report date, excluding items arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3. Notes B, C and D .... $ ______ 4588

   A. Number of items .... ______ 4589

OMIT PENNIES

3. The system and procedures utilized in complying with the requirement to maintain physical possession or control of customers' fully paid and excess margin securities have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 15c3-3 .... Yes ______ 4584 No ______ 4585

NOTES

A—Do not include in item one customers' fully paid and excess margin securities required by Rule 15c 3-3 to be in possession or control but for which no action was required by the respondent as of the report date or required action was taken by respondent within the time frames specified under Rule 15c3-3.

B—State separately in response to items one and two whether the securities reported in response thereto were subsequently reduced to possession or control by the respondent.

C—Be sure to include in item two only items not arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3.

D—Item two must be responded to only with report which is filed as of the date selected for the broker's or dealer's annual audit of financial statements, whether or not such date is the end of a calendar quarter. The response to item two should be filed within 60 calendar days after such date, rather than with the remainder of this report. This information may be required on a more frequent basis by the Commission or the designated examining authority in accordance with Rule 17a-5(a)(2)(iv).

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E F Hutton & Company Inc as of February 29 1980

SCHEDULE OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION

CUSTOMERS' REGULATED COMMODITY FUTURES ACCOUNTS

SEGREGATION REQUIREMENTS

1. Net ledger balance		
a. Cash	$ 107 175 000	7010
b. Securities (at market)	194 030 000	7020
2. Net unrealized profit (loss) in open futures contracts	6 212 000	7030
3. Net equity (Deficit) (Total of 1 - plus or minus 2)	307 417 000	7040
4. Add: accounts liquidating to a deficit and accounts with debit balances with no open trades	28 663 000	7050
5. Amount required to be segregated (Total of 3 & 4	$ 336 080 000	7060

FUNDS ON DEPOSIT IN SEGREGATION

6. Deposited in segregated funds bank accounts:		
a. Cash	107 013 000	7070
b. Securities representing investments of customers' funds (at market)	—	7080
c. Securities held for customers in lieu of cash margins (at market)	194 030 000	7090
7. Margins on deposit with clearing organizations of contract markets:		
a. Cash	21 796 000	7100
b. Securities representing investments of customers' funds (at market)	20 928 000	7110
c. Securities held for customers in lieu of cash margins (at market)	—	7120
8. Settlement due from (to) contract market clearing organization	(4 979 000)	7130
9. Net equities with other FCMs	7000	7140
10. Segregated funds on hand:		
a. Cash	—	7150
b. Securities representing investments of customers' funds (at market)	—	7160
c. Securities held for customers in lieu of cash margins (at market)	—	7170
11. Total amount in segregation (Total of 6 through 10)	$ 338 795 000	7180
12. Excess funds (insufficiency) in segregation (11 minus 5)	$ 2 715 000	7190

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E F HUTTON & COMPANY INC **as of** FEBRUARY 28 1985

Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, (as defined below), which have not been deducted in the computation of Net Capital.

Type of Proposed withdrawal or Accrual See below for code to enter		Name of Lender or Contributor		Insider or Outsider? (In or Out)		Amount to be Withdrawn (cash amount and/or Net Capital Value of Securities)		(MMDDYY) Withdrawal or Maturity Date		Expect to Renew (yes or no)	
2	4600	FIRST INTERSTATE BANK	4601	OUT	4602	$ 1000000	4603	3/31/85	4604	NO	4605
2	4610	FIRST INTERSTATE BANK	4611	OUT	4612	1000000	4613	6/30/85	4614	NO	4615
	4620		4621		4622		4623		4624		4625
	4630		4631		4632		4633		4634		4635
	4640		4641		4642		4643		4644		4645
	4650		4651		4652		4653		4654		4655
	4660		4661		4662		4663		4664		4665
	4670		4671		4672		4673		4674		4675
	4680		4681		4682		4683		4684		4685
5	4690		4691		4692	19800000	4693		4694		4695

TOTAL $ 21800000 4699*

OMIT PENNIES

*To agree with the total on Recap (Item No. 4880)

Instructions: Detail listing must include the total of items maturing during the six month period following the report date, regardless of whether or not the capital contribution is expected to be renewed. The schedule must also include proposed capital withdrawals scheduled within the six month period following the report date including the proposed redemption of stock and payments of liabilities secured by fixed assets (which are considered allowable assets in the capital computation pursuant to Rule 15c3-1(c)(2)(iv)), which could be required by the lender on demand or in less than six months.

WITHDRAWAL CODE:	DESCRIPTION
1.	Equity Capital
2.	Subordinated Liabilities
3.	Accruals
4.	15c3-1(c)(2)(iv) Liabilities
5	AGGREGATE CREDIT EXTENDED TO CUSTOMERS ON RESTRICTED SECURITIES

FINANCIAL AN. .PERATIONAL COMBINED UNIFORI .NGLE REPORT
Capital Withdrawals
PART II

BROKER OR DEALER E F Hutton & Company Inc For the period (MMDDYY) from February [illegible] to February [illegible]

RECAP

Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, which have not been deducted in the computation of net capital.

1. **Equity Capital**		
A. Partnership Capital		
1. General Partners	$	4700
2. Limited		4710
3. Undistributed Profits		4720
4. Other (describe below)		4730
5. Sole Proprietorship		4735
B. Corporation Capital		
1. Common Stock		4740
2. Preferred Stock		4750
3. Retained Earnings (Dividends and Other)		4760
4. Other (describe below)		4770
2. **Subordinated Liabilities**		
A. Secured Demand Notes		4780
B. Cash Subordinations		4790
C. Debentures	2 000 000	4800
D. Other (describe below)		4810
3. **Other Anticipated Withdrawals**		
A. Bonuses		4820
B. Voluntary Contributions to Pension or Profit Sharing Plans		4860
C. Other (describe below)	19800 000	4870
Total	$ 21 800 000	[illegible]

4. **Description of Other**

Corporate credit extended to customers on restricted securities

STATEMENT OF CHANGES IN OWNERSHIP EQUITY (SOLE PROPRIETORSHIP, PARTNERSHIP OR CORPORATION)

1. Balance, beginning of period			$ 476 779 000	4240
A. Net income (loss)			854 000	4250
B. Additions (Includes non-conforming capital of	$	4262	) -0-	4260
C. Deductions (Includes non-conforming capital of	$	4272	) -0-	4270
2. Balance, end of period (From item 1800)			$ 477 633 000	4290

STATEMENT OF CHANGES IN LIABILITIES SUBORDINATED TO CLAIMS OF GENERAL CREDITORS

3. Balance, beginning of period	$ 145 683 000	4300
A. Increases		4310
B. Decreases	( )	4320
4. Balance, end of period (From item 3520)	$ 153,035 000	4330

OMIT PENNIES

FORM X-17A-5

4/81

FOCUS REPORT

(Financial and Operational Combined Uniform Single Report)

PART I OR PART II

☒ 10 ☐ 11

(Read instructions before preparing Form)

This report is being filed pursuant to (Check Applicable Block(s)):

1) Rule 17a-5(a) ☒ 16
2) Rule 17a-5(b) ☐ 17
3) Rule 17a-11 ☐ 18
4) Special request by designated examining authority ☐ 19
5) Other ☐ 26

NAME OF BROKER-DEALER: E.F. Hutton & Company Inc. 13

SEC FILE NO. 14

FIRM I.D. NO. 13-1937069 15

ADDRESS OF PRINCIPAL PLACE OF BUSINESS (Do not use P.O. Box No.)

One Battery Park Plaza 20
(No. and Street)

New York 21 (City) New York 22 (State) 10004 23 (Zip)

FOR PERIOD BEGINNING (MM/DD/YY) February 1, 1985 24

AND ENDING (MM/DD/YY) February 28, 1985 25

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Michael P. Castellano 30

(Area Code—Telephone No.) (212) 742-3546 31

NAME(S) OF SUBSIDIARIES OR AFFILIATES CONSOLIDATED IN THIS REPORT PURSUANT TO APPENDIX C OF RULE 15C3-1		CHECK IF GUARANTEED		CHECK IF FLOW THROUGH	
E.F. Hutton International Inc.	32	X	50		33
	34		51		35
	36		52		37
	38		53		39

DOES RESPONDENT CARRY ITS OWN CUSTOMER ACCOUNTS? YES ☒ 40 NO ☐ 41

DOES RESPONDENT CLEAR TRANSACTIONS? YES ☒ 43 NO ☐ 44

CHECK HERE IF RESPONDENT IS FILING AN AUDITED REPORT ☐ 42

EXECUTION:

The registrant/broker or dealer submitting this Form and its attachments and the person(s) by whom it is executed represent hereby that all information contained therein is true, correct and complete. It is understood that all required items, statements, and schedules are considered integral parts of this Form and that the submission of any amendment represents that all unamended items, statements and schedules remain true, correct and complete as previously submitted. See general instructions for reporting contractural and contingent liabilities.

Dated the 25th day of March 19 85

Manual Signatures of:

1) Robert Fomon
Principal Executive Officer or Managing Partner

2)
Principal Financial Officer or Partner

3)
Principal Operations Officer or Partner

ATTENTION— Intentional misstatements or omissions of facts constitute Federal Criminal Violations. (See 18 U.S.C. 1001 and 15 U.S.C. 78ff (a).)

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART I (OR PART II)

BROKER OR DEALER E. F. Hutton & Company Inc. as of February 28, 198

FINANCIAL AND OPERATIONAL DATA
Operational Deductions From Capital (Note A)

	I No. of Items		II Debits (Short Value)		III Credits (Long Value)		IV Deductions in Computing Net Capital	
1. Money suspense and balancing differences		5610	$	5810	$	6010	$ -0-	6012
2. Security suspense and differences with related money balances L		5620		5820		6020	278,000	6022
S		5625		5825		6025	-0-	6027
3. Market value of short and long security suspense and differences without related money (other than reported in line 4., below)		5630		5830		6030	615,000	6032
4. Market value of security record breaks		5640		5840		6040	-0-	6042
5. Unresolved reconciling differences with others:								
A. Correspondents and Broker/Dealers L		5650		5850		6050	-0-	6052
S		5655		5855		6055	-0-	6057
B. Depositories		5660		5860		6060	-0-	6062
C. Clearing Organizations L		5670		5870		6070	-0-	6072
S		5675		5875		6075	-0-	6077
D. Inter-company Accounts		5680		5880		6080	-0-	6082
E. Bank Accounts and Loans		5690		5890		6090	215,000	6092
F. Other		5700		5900		6100	-0-	6102
G. (Offsetting) Items A. through F.		5720	( )	5920	( )	6120	▨	▨
TOTAL Line 5.		5730		5930		6130	215,000	6132
6. Commodity Differences		5740		5940		6140	-0-	6142
7. Open transfers and reorganization account items over 40 days not confirmed or verified		5760		5960		6160	-0-	6162
8. TOTAL (Lines 1.-7.)		5770	$	5970	$	6170	$ 1,108,000	6172
9. Lines 1.-8. resolved subsequent to report date		5775	$	5975	$	6175	$	6177
10. Aged Fails—to deliver	630	5780	$22,258	5980	$ 22,073	6180	$ 2,817,000	6182
—to receive	231	5785	$16,109	5985	$ 16,083	6185	$ 296,000	6187
			(Omit 000's)		(Omit 000's)		(Omit Pennies)	

NOTE A—This section must be completed as follows:

1. All member organizations must complete column IV, lines 1. through 8. and 10., reporting deductions from capital as of the report date whether resolved subsequently or not (see instructions relative to each line item).
2. a. Columns I, II and III of lines 1. through 8. and 10. must be completed when a Part II filing is required.
   b. Columns I, II and III of lines 1. through 8. must be completed with a Part I filing, only if the total deduction on line 8. column IV equals or exceeds 25% of excess net capital as of the prior month end reporting date. All columns of line 10. require completion.
3. A response to line 9., cols. I through IV and the "Potential Operational Charges Not Deducted From Capital" schedule on p. 3 are required only if:
   a. the parameters cited in 2.b. above exist; and
   b. the total deduction, line 8. column IV, for the current month exceeds the total deductions for the prior month by 50% or more.
4. All columns and line items (1. through 10.) must be answered if required. If respondent has nothing to report enter -0-.

....

Other Operational Data (Items 1., 2. and 3. below require an answer)

Item 1. Have the accounts enumerated on lines 5.A. through F. above been reconciled with statements received from others within 35 days for lines 5.A through D. and 65 days for lines 5.E. and F. prior to the report date and have all reconciling differences been appropriately comprehended in the computation of net capital at the report date? If this has not been done in all respects, answer No.

Yes X 5600
No 5601

Item 2. Do the respondent's books reflect a concentrated position (See Instruction) in commodities? If Yes report the totals (000 omitted) in accordance with the specific Instructions; if No answer -0- for:
A. Firm Trading and Investment Accounts
B. Customers' and Non-Customers' and Other Accounts

A. -0- 5602
B. -0- 5603

Item 3. Does respondent have any planned operational or organizational changes? (Answer Yes or No based on specific Instructions.)

Yes 5604
No X 5605

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART I (OR PART II)

BROKER OR DEALER E. F. Hutton & Company Inc. as of February 28, 198

FINANCIAL AND OPERATIONAL DATA
Operational Deductions From Capital (Note A)

	I No. of Items		II Debits (Short Value)		III Credits (Long Value)		IV Deductions in Computing Net Capital	
1. Money suspense and balancing differences		5610	$	5810	$	6010	$ -0-	6012
2. Security suspense and differences with related money balances L		5620		5820		6020	278,000	6022
S		5625		5825		6025	-0-	6027
3. Market value of short and long security suspense and differences without related money (other than reported in line 4., below)		5630		5830		6030	615,000	6032
4. Market value of security record breaks		5640		5840		6040	-0-	6042
5. Unresolved reconciling differences with others:								
A. Correspondents and Broker/Dealers L		5650		5850		6050	-0-	6052
S		5655		5855		6055	-0-	6057
B. Depositories		5660		5860		6060	-0-	6062
C. Clearing Organizations L		5670		5870		6070	-0-	6072
S		5675		5875		6075	-0-	6077
D. Inter-company Accounts		5680		5880		6080	-0-	6082
E. Bank Accounts and Loans		5690		5890		6090	215,000	6092
F. Other		5700		5900		6100	-0-	6102
G. (Offsetting) Items A. through F.		5720	( )	5920	( )	6120	▨	▨
TOTAL Line 5.		5730		5930		6130	215,000	6132
6. Commodity Differences		5740		5940		6140	-0-	6142
7. Open transfers and reorganization account items over 40 days not confirmed or verified		5760		5960		6160	-0-	6162
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—to receive	231	5785	$16,109	5985	$ 16,083	6185	$ 296,000	6187
			(Omit 000's)		(Omit 000's)		(Omit Pennies)	

NOTE A—This section must be completed as follows:

1. All member organizations must complete column IV, lines 1. through 8. and 10., reporting deductions from capital as of the report date whether resolved subsequently or not (see instructions relative to each line item).
2. a. Columns I, II and III of lines 1. through 8. and 10. must be completed when a Part II filing is required.
   b. Columns I, II and III of lines 1. through 8. must be completed with a Part I filing, only if the total deduction on line 8. column IV equals or exceeds 25% of excess net capital as of the prior month end reporting date. All columns of line 10. require completion.
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   a. the parameters cited in 2.b. above exist; and
   b. the total deduction, line 8. column IV, for the current month exceeds the total deductions for the prior month by 50% or more.
4. All columns and line items (1. through 10.) must be answered if required. If respondent has nothing to report enter -0-.

* * *

Other Operational Data (Items 1., 2. and 3. below require an answer)

Item 1. Have the accounts enumerated on lines 5.A. through F. above been reconciled with statements received from others within 35 days for lines 5.A through D. and 65 days for lines 5.E. and F. prior to the report date and have all reconciling differences been appropriately comprehended in the computation of net capital at the report date? If this has not been done in all respects, answer No.
Yes X 5600
No 5601

Item 2. Do the respondent's books reflect a concentrated position (See instruction) in commodities? If Yes report the totals ($000 omitted) in accordance with the specific instructions; if No answer -0- for:
A. Firm Trading and Investment Accounts
B. Customers' and Non-Customers' and Other Accounts
A. -0- 5602
B. -0- 5603

Item 3. Does respondent have any planned operational or organizational changes? (Answer Yes or No based on specific instructions.)
Yes 5604
No X 5605

PART I
FOCUS REPORT

		ITEM
N 1	For Current Month	100
AS OF (MMDDYY)	February 28, 1985	99
SEC FILE NO.		98

BROKER — DEALER

E. F. Hutton & Company Inc.

ITEM	(OMIT PENNIES)	
1. Subordinated Loan Agreements—Cash	153,035,000	1710
2. Secured Demand Notes—Face Amount	-	1730
3. Total Subordinations Allowable for Net Capital	153,035,000	3620
4. Ownership Equity/Partnership Capital—Beginning of Month	476,779,000	3501
5. Unconsolidated Income/Expense for the Month:		
a. Trading and Investment Account Profit or (Loss)	(3,034,000)	3661
b. Other Gross Income (Loss)	173,705,000	4212
c. Expenses	170,897,000	4201
d. Federal Income Taxes	(1,080,000)	4221
6. Net Profit or (Loss) for the Month	854,000	4250
7. Other (Exclude Non-Conforming Capital)		
a. Additions to Capital	-	4264
b. Deductions from Capital	-	4274
8. Ownership Equity/Partnership Capital—End of Month	477,633,000	3500
9. Other (Deductions) or Allowable Credits	-	3525
10. Total Capital and Allowable Subordinations	630,668,000	3530
Deductions and/or Charges to Capital		
11. Added Charges Customer and Non-Customer		
a. Security Accounts	5,583,000	3550
a. Commodity Accounts	2,167,000	3560
12. Operational Deductions from Capital (Page 2 Line 8 Col. IV)	1,108,000	3575
13. Non-Allowable Assets (Not Includable Above)	337,155,000	3541
14. Proprietary Charges on Commodities	3,049,000	3600
15. Other Charges and/or Deductions	3,781,000	3612
16. Total Deductions and/or Charges (Lines 11 thru 15)	352,843,000	3620
17. Net Capital—Before Haircuts on Securities	277,825,000	3640
18. Haircuts on Proprietary Security Positions (Including Contractual Commitments)	108,117,000	3740
19. Net Capital	169,708,000	3750
20. Scheduled Capital Withdrawals Within 6 Months	21,800,000	4880
21. Net Capital After Withdrawals	147,908,000	4881
22. Total Equity Subordinations	-	1011
23. a. Aggregate Indebtedness under SEC Rule 15c3-1	-	3840
b. Aggregate Debits under SEC Rule 15c3-3 as Adjusted	1,880,307,000	4470
24. Minimum Net Capital Required	37,631,000	3760
25. Ratios/Excess Net Capital		
a. Aggregate Indebtedness to Net Capital	% -	3850
b. Net Capital to Aggregate Debit Items	% 9.03	3851
c. Net Capital in Excess of Greater of 6 2/3% of AI or Minimum	-	3770
d. Net Capital in Excess of Greater of 2% of ADI or Minimum	132,077,000	3910
e. Option Deductions/Net Capital Ratio	% -	3852
26. Total Credits—Rule 15c3-3 Reserve Formula	1,793,796,000	4430
27. Total Debits—Rule 15c3-3 Reserve Formula—Net	1,814,417,000	4472
28. Amount in Reserve Bank Account	140,000,000	4530
29. Commodity Exchange Act—Segregation Requirement		
a. Amount Required to be Segregated	336,080,000	7060
b. Amount Segregated	338,795,000	7150
30. Firm Proprietary Positions		
a. Long—Contractual Commitments—Certain Exempt Securities	837,990,000	841
b. Short—Contractual Commitments—Certain Exempt Securities	1,338,794,000	1621
31. Customer and Non-Customer Charges—Certain Exempt Securities	-	3551
32. a. Security Concentration—Firm	-	5371
b. Security Concentration—Customer	-	5372
33. Total Tickets	1,023,258	4980
34.		
35.		
36.		
37.		
38.		
39.		

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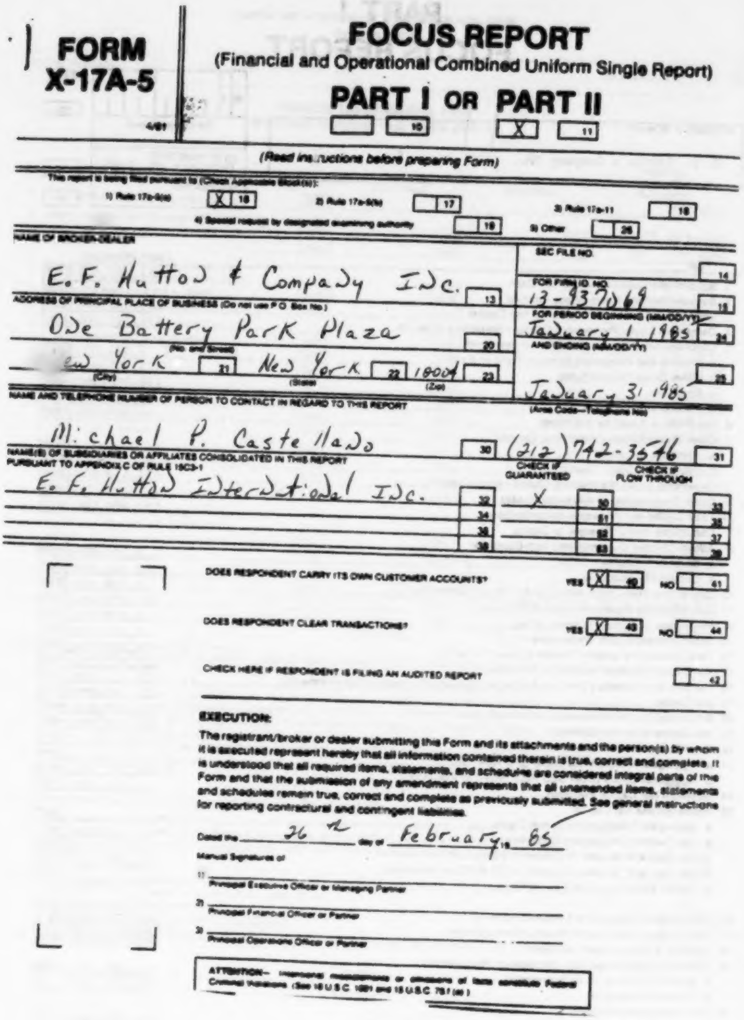


FORM X-17A-5

4/81

FOCUS REPORT

(Financial and Operational Combined Uniform Single Report)

PART I OR PART II

☐ 10 ☒ 11

(Read instructions before preparing Form)

This report is being filed pursuant to (Check Applicable Block(s)):

1) Rule 17a-5(a) ☒ 16 2) Rule 17a-5(b) ☐ 17 3) Rule 17a-11 ☐ 18

4) Special request by designated examining authority ☐ 19 5) Other ☐ 26

NAME OF BROKER-DEALER: E.F. Hutton & Company Inc. 13

SEC FILE NO. 14

FOR FIRM ID NO. 13-937069 15

ADDRESS OF PRINCIPAL PLACE OF BUSINESS (Do not use P.O. Box No.)

One Battery Park Plaza 20
(No. and Street)

ew York 21 (City) New York 22 (State) 10004 23 (Zip)

FOR PERIOD BEGINNING (MM/DD/YY) January 1 1985 24

AND ENDING (MM/DD/YY) January 31 1985 25

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Michael P. Castellano 30 (212) 742-3546 31
(Area Code—Telephone No.)

NAME(S) OF SUBSIDIARIES OR AFFILIATES CONSOLIDATED IN THIS REPORT PURSUANT TO APPENDIX C OF RULE 15C3-1

		CHECK IF GUARANTEED		CHECK IF FLOW THROUGH
E.F. Hutton International Inc.	32	X	50	33
	34		51	35
	36		52	37
	38		53	39

DOES RESPONDENT CARRY ITS OWN CUSTOMER ACCOUNTS? YES ☒ 40 NO ☐ 41

DOES RESPONDENT CLEAR TRANSACTIONS? YES ☒ 43 NO ☐ 44

CHECK HERE IF RESPONDENT IS FILING AN AUDITED REPORT ☐ 42

EXECUTION:

The registrant/broker or dealer submitting this Form and its attachments and the person(s) by whom it is executed represent hereby that all information contained therein is true, correct and complete. It is understood that all required items, statements, and schedules are considered integral parts of the Form and that the submission of any amendment represents that all unamended items, statements and schedules remain true, correct and complete as previously submitted. See general instructions for reporting contractural and contingent liabilities.

Dated the 26 th day of February 19 85

Manual Signatures of:

1) ______________________
Principal Executive Officer or Managing Partner

2) ______________________
Principal Financial Officer or Partner

3) ______________________
Principal Operations Officer or Partner

ATTENTION— Intentional misstatements or omissions of facts constitute Federal Criminal Violations. (See 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).)

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. HUTTON & COMPANY. INC N 2 [100]

STATEMENT OF FINANCIAL CONDITION

As of (MM/DD/YY) JANUARY 31, 1985 [99]
SEC FILE NO. ____ [98]

Consolidated ☒ [198]
Unconsolidated ☐ [199]

ASSETS

	Allowable	Nonallowable	Total
1. Cash	$ 46810 000 [200]		$ 46 810 000 [750]
2. Cash segregated in compliance with federal and other regulations	119 111 000 [210]		119 111 000 [760]
3. Receivable from brokers or dealers and clearing organizations:			
A. Failed to deliver:			
1. Includable in "Formula for Reserve Requirements"	41 364 000 [220]		
2. Other	101 259 000 [230]		142659000 [770]
B. Securities borrowed:			
1. Includable in "Formula for Reserve Requirements"	-0- [240]		
2. Other	854798000 [250]		854 798 000 [780]
C. Omnibus accounts:			
1. Includable in "Formula for Reserve Requirements"	-0- [260]		
2. Other	23 143 000 [270]		23 143 000 [790]
D. Clearing organizations:			
1. Includable in "Formula for Reserve Requirements"	163 000 [280]		
2. Other	50470 000 [290]		50633 000 [800]
E. Other	198 132 000 [300]	$ -0- [550]	198 132 000 [810]
4. Receivables from customers:			
A. Securities accounts:			
1. Cash and fully secured accounts	1776038000 [310]		
2. Partly secured accounts	329 000 [320]	54 000 [560]	
3. Unsecured accounts		9502 000 [570]	
B. Commodity accounts	74091 000 [330]	25 381 000 [580]	
C. Allowance for doubtful accounts	(-0-) [335]	(29489 000) [590]	1855906 000 [820]
5. Receivables from non-customers:			
A. Cash and fully secured accounts	18 655 000 [340]		
B. Partly secured and unsecured accounts	-0- [350]	-0- [600]	18 655 [illegible] [830]
6. Securities purchased under agreements to resell	6544609000 [360]	- 0 [605]	6544[illegible] [840]
7. Securities and spot commodities owned, at market value:			
A. Bankers acceptances, certificates of deposit and commercial paper	25 996 000 [370]		
B. U.S. and Canadian government obligations	912 741 000 [380]		
C. State and municipal government obligations	322 932 000 [390]		
D. Corporate obligations	519362 000 [400]		

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc as of January 31, 1985

STATEMENT OF FINANCIAL CONDITION

ASSETS

	Allowable	Nonallowable	Total
E. Stocks and warrants	$ 301585 000 [410]		
F. Options	36307 000 [420]		
G. Arbitrage	— 0 — [422]		
H. Other securities	38588 000 [424]		
I. Spot commodities	[430]		$ 3043816 000 [850]
8. Securities owned not readily marketable:			
A. At Cost $ — 0 — [130]			
B. At estimated fair value	— 0 — [440]	$ — 0 — [610]	— 0 — [860]
9. Other investments not readily marketable:			
A. At Cost $ 2499 000 [140]			
B. At estimated fair value	[450]	3182 000 [620]	3182 000 [870]
10. Securities borrowed under subordination agreements and partners' individual and capital securities accounts, at market value:			
A. Exempted securities $ — 0 — [150]			
B. Other $ — 0 — [160]	$ — 0 — [460]	— 0 — [630]	— 0 — [880]
11. Secured demand notes-market value of collateral:			
A. Exempted securities $ — 0 — [170]			
B. Other $ — 0 — [180]	— 0 — [470]	— 0 — [640]	— 0 — [890]
12. Memberships in exchanges:			
A. Owned, at market value $ 12581000 [190]			
B. Owned at cost		5161000 [650]	
C. Contributed for use of company, at market value		$ — 0 — [660]	5161000 [900]
13. Investment in and receivables from affiliates, subsidiaries and associated partnerships	— 0 — [480]	5372 000 [670]	$ 5372 000 [910]
14. Property, furniture, equipment, leasehold improvements and rights under lease agreements: At cost (net of accumulated depreciation and amortization)	— 0 — [490]	153656000 [680]	153656 000 [920]
15. Other Assets:			
A. Dividends and interest receivable	11362 000 [500]	3832 000 [690]	
B. Free shipments	5639 000 [510]	340 000 [700]	
C. Loans and advances	845 000 [520]	34242 000 [710]	
D. Miscellaneous	$ 146 720 000 [530]	192773 000 [720]	321908000 [930]
16. TOTAL ASSETS	$ 1313546 000 [540]	$ 322 912 000 [740]	$ 1338645 000 [940]

OMIT PENNIES

· FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc as of January 24 1985

STATEMENT OF FINANCIAL CONDITION

LIABILITIES AND OWNERSHIP EQUITY

Liabilities	A.I. Liabilities *	Non-A.I. Liabilities *	Total
17. Bank loans payable			
A. Includable in "Formula for Reserve Requirements"	$ [1030]	$ [1240]	$ 208 489 000 [1460]
B. Other	[1040]	[1250]	218 654 000 [1470]
18. Securities sold under repurchase agreements		[1260]	6 348 706 000 [1480]
19. Payable to brokers or dealers and clearing organizations:			
A. Failed to receive:			
1. Includable in "Formula for Reserve Requirements"	[1050]	[1270]	37 460 000 [1490]
2. Other	[1060]	[1280]	454 919 000 [1500]
B. Securities loaned:			
1. Includable in "Formula for Reserve Requirements"	[1070]		▼ 492 383 000 [1510]
2. Other	▼ [1080]	[1290]	474 841 000 [1520]
C. Omnibus accounts:			
1. Includable in "Formula for Reserve Requirements"	[1090]		- 0 - [1530]
2. Other	[1095]	▼ [1300]	3 989 000 [1540]
D. Clearing organizations:			
1. Includable in "Formula for Reserve Requirements"	[1100]		258 000 [1550]
2. Other	[1105]	[1310]	16 228 000 [1560]
E. Other	[1110]	[1320]	59 334 000 [1570]
20. Payable to customers:			
A. Securities accounts - including free credits of ▼ $ 919 375 000 [950]	[1120]		▼ 972 196 000 [1580]
B. Commodities accounts	▼ [1130]	[1330]	170 115 000 [1590]
21. Payable to non customers:			
A. Securities accounts	[1140]	[1340]	914 000 [1600]
B. Commodities accounts	[1150]	[1350]	641 000 [1610]
22. Securities sold not yet purchased at market value - including arbitrage of $ - 0 [960]		[1360]	216 354 000 [1620]
23. Accounts payable and accrued liabilities and expenses:			
A. Drafts payable	[1160]		3 076 000 [1630]
B. Accounts payable	[1170]		190 949 000 [1640]
C. Income taxes payable	[1180]		▼ 38 036 000 [1650]
D. Deferred income taxes		▼ [1370]	- 0 - [1660]
E. Accrued expenses and other liabilities	[1190]		962 760 000 [1670]
F. Other	▼ [1200]	[1380]	49 632 000 [1680]

OMIT PENNIES

*Brokers or Dealers electing the alternative net capital requirement method need not complete these columns.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton + Company Inc as of January 31, 1985

STATEMENT OF FINANCIAL CONDITION

LIABILITIES AND OWNERSHIP EQUITY (continued)

Liabilities	A.I. Liabilities *	Non-A.I. Liabilities *	Total
24. Notes and mortgages payable:			
A. Unsecured	$ [1210]		$ [1690]
B. Secured	$ [1211]	$ [1390]	[1700]
25. Liabilities subordinated to claims of general creditors:			
A. Cash borrowings		[1400]	145683000 [1710]
1. from outsiders $ 17000 000 [970]			
2. Includes equity subordination (15c3-1 (d)) of $ [980]			
B. Securities borrowings, at market value; from outsiders $ [990]		[1410]	[1720]
C. Pursuant to secured demand note collateral agreements,		[1420]	$ [1730]
1. from outsiders $ [1000]			
2. Includes equity subordination (15c3-1 (d)) of $ [1010]			
D. Exchange memberships contributed for use of company at market value		$ [1430]	[1740]
E. Accounts and other borrowings not qualified for net capital purposes	[1220]	[1440]	6005000 [1750]
26. TOTAL LIABILITIES	$ [1230]	$ [1450]	$ 12909679 000 [1760]

Ownership Equity

27. Sole proprietorship	$ [1770]
28. Partnership limited partners $ [1020]	[1780]
29. Corporation	
A. Preferred stock	- 0 - [1791]
B. Common stock	$ 2 000 [1792]
C. Additional paid-in capital	95 914 - [1793]
D. Retained earnings	380 863 000 [1794]
E. Total	476 779 000 [1795]
F. Less capital stock in treasury	(- 0 -) [1796]
30. TOTAL OWNERSHIP EQUITY	$ 476 779 000 [1800]
31. TOTAL LIABILITIES AND OWNERSHIP EQUITY	$ 13386 458 000 [1810]

OMIT PENNIES

*Brokers or Dealers electing the alternative net capital requirement method need not complete these columns.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. HUTTON + Company Inc as of January 31, 1985

COMPUTATION OF NET CAPITAL

1. Total ownership equity (from Statement of Financial Condition – Item 1800)					$ 476 779 000	3480
2. Deduct: Ownership equity not allowable for net capital					(- 0 -)	3490
3. Total ownership equity qualified for net capital					476 779 000	3500
4. Add:						
A. Liabilities subordinated to claims of general creditors allowable in computation of net capital					146 683 000	3520
B. Other (deductions) or allowable credits (List)					- 0 -	3525
5. Total capital and allowable subordinated liabilities					$ 623 462 000	3530
6. Deductions and/or charges:						
A. Total non-allowable assets from Statement of Financial Condition (Note B and C)			$ 332 912 000	3540		
1. Additional charges for customers' and non-customers' security accounts			3 414 000	3550		
2. Additional charges for customers' and non-customers' commodity accounts			1 893 000	3560		
B. Aged fail-to-deliver:			326 000	3570		
1. Number of items	610	3450				
C. Aged short security differences-less reserve of	$ - 0 -	3460	806 000	3580		
number of items	73	3470				
D. Secured demand note deficiency			- 0 -	3590		
E. Commodity futures contracts and spot commodities – proprietary capital charges			939 000	3600		
F. Other deductions and/or charges			4 099 000	3610		
G. Deductions for accounts carried under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x)			- 0 -	3615		
H. Total deductions and/or charges					(343 588 000)	3620
7. Other additions and/or allowable credits (List)						3630
8. Net Capital before haircuts on securities positions					$ 279 874 000	3640
9. Haircuts on securities: (computed, where applicable, pursuant to 15c3-1 (f)):						
A. Contractual securities commitments			1 584 000	3660		
B. Subordinated securities borrowings			- 0 -	3670		
C. Trading and investment securities						
1. Bankers' acceptances, certificates of deposit and commercial paper			3 322 000	3680		
2. U.S. and Canadian government obligations			15 907 000	3690		
3. State and municipal government obligations			15 772 000	3700		
4. Corporate obligations			43 190 000	3710		
5. Stocks and warrants			18 107 000	3720		
6. Options			4 099 000	3730		
7. Arbitrage			- 0 -	3732		
8. Other securities			2 703 000	3734		
D. Undue concentration			- 0 -	3650		
E. Other (list)			49 000	3736	(104 946 000)	3740
10. Net Capital					$ 173 928 000	3750

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. Hutton & Company Inc as of January 31, 1985

COMPUTATION OF BASIC NET CAPITAL REQUIREMENT

Part A

11. Minimum net capital required (6-2/3% of line 19) $ ______ [3756]
12. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A) $ ______ [3758]
13. Net capital requirement (greater of line 11 or 12) $ ______ [3760]
14. Excess net capital (line 10 less 13) $ ______ [3770]
15. Excess net capital at 1000% (line 10 less 10% of line 19) $ ______ [3780]

COMPUTATION OF AGGREGATE INDEBTEDNESS

16. Total A.I. liabilities from Statement of Financial Condition $ ______ [3790]
17. Add:
    A. Drafts for immediate credit $ ______ [3800]
    B. Market value of securities borrowed for which no equivalent value is paid or credited $ ______ [3810]
    C. Other unrecorded amounts (List) $ ______ [3820] $ ______ [3830]
18. Deduct: Adjustment based on deposits in Special Reserve Bank Accounts (15c3-1 (c) (1) (vii)) $ ______ [3838]
19. Total aggregate indebtedness $ ______ [3840]
20. Percentage of aggregate indebtedness to net capital (line 19 ÷ by line 10) % ______ [3850]
21. Percentage of Aggregate Indebtedness to net capital *after* anticipated capital withdrawals (line 19 ÷ by line 10 less item 4880 page 11) % ______ [3853]

COMPUTATION OF ALTERNATE NET CAPITAL REQUIREMENT

Part B

22. 4% of combined aggregate debit items as shown in Formula for Reserve Requirements pursuant to Rule 15c3-3 prepared as of the date of the net capital computation including both brokers or dealers and consolidated subsidiaries' debits $ 36 652 000 [3870]
23. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A) $ 36 677 000 [3880]
24. Net capital requirement (greater of line 22 or 23) $ 36 677 000 [3760]
25. Excess net capital (line 10 less 24) $ 116 688 000 [3910]
26. Percentage of Net Capital to Aggregate Debits (line 10 ÷ by line 17 page 8) % 837 [3851]
27. Percentage of Net Capital, *after* anticipated capital withdrawals, to Aggregate Debits (line 10 less item 4880 page 11 ÷ by line 17 page 8) % 705 [3854]
28. Net capital in excess of the greater of:
    A. 5% of combined aggregate debit items or $120,000 $ 803[illegible] [3920]
    B. 7% of combined aggregate debit items or $120,000 $ 6673[illegible] [3930]

OTHER RATIOS

Part C

29. Percentage of debt to debt-equity total computed in accordance with Rule 15c3-1 (d) % 2406 [3860]
30. Options deductions/Net Capital ratio (1000% test) total deductions exclusive of liquidating equity under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x) ÷ Net Capital % ______ [3852]

NOTES:

(A) The minimum net capital requirement should be computed by adding the minimum dollar net capital requirement of the reporting broker dealer and, for each subsidiary to be consolidated, the greater of:
1. Minimum dollar net capital requirement, or
2. 6-2/3% of aggregate indebtedness or 4% of aggregate debits if alternative method is used.

(B) Do not deduct the value of securities borrowed under subordination agreements or secured demand notes covered by subordination agreements not in satisfactory form and the market values of memberships in exchanges contributed for use of company (contra to item 1740) and partners' securities which were included in non-allowable assets.

(C) For reports filed pursuant to paragraph (d) of Rule 17a-5, respondent should provide a list of material non-allowable assets.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton + Company .Inc as of January 31, 1985

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS FOR BROKER-DEALERS UNDER RULE 15c3-3
(See Rule 15c3-3, Exhibit A and Related Notes)

CREDIT BALANCES

1. Free credit balances and other credit balances in customers' security accounts (see Note A, Exhibit A, Rule 15c3-3)	$ 883 317 000	4340		
2. Monies borrowed collateralized by securities carried for the accounts of customers (see Note B)	—	4350		
3. Monies payable against customers' securities loaned (see Note C)	492 383 000	4360		
4. Customers' securities failed to receive (see Note D)	139 064 000	4370		
5. Credit balances in firm accounts which are attributable to principal sales to customers	214 816 000	4380		
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days	42 000	4390		
7. **Market value of short security count differences over 30 calendar days old	6 000	4400		
8. **Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days	2 890 000	4410		
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days	44 495 000	4420		
10. Other (List)	- 0 -	4425		
11. TOTAL CREDITS			$ 1 727 013 000	4430

DEBIT BALANCES

12. **Debit balances in customers' cash and margin accounts excluding unsecured accounts and accounts doubtful of collection net of deductions pursuant to Note E, Exhibit A, Rule 15c3-3	$ 1656 003 000	4440		
13. Securities borrowed to effectuate short sales by customers and securities borrowed to make delivery on customers' securities failed to deliver	—	4450		
14. Failed to deliver of customers' securities not older than 30 calendar days	171 374 000	4460		
15. Margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in customer accounts (See Note F)		4465		
16. Other (List)		4469		
17. **Aggregate debit items			$ 1 827 377 000	4470
18. **less 3% (for alternative method only — see Rule 15c3-1 (f) (5) (i))			(54 821 000)	4471
19. **TOTAL 15c3-3 DEBITS			$ 1 772 556 000	4472

RESERVE COMPUTATION

20. Excess of total debits over total credits (line 19 less line 11)	$ 45 543 000	4480
21. Excess of total credits over total debits (line 11 less line 19)		4490
22. If computation permitted on a monthly basis, enter 105% of excess of total credits over total debits		4500
23. Amount held on deposit in "Reserve Bank Account(s)", including value of qualified securities, at end of reporting period		4510
24. Amount of deposit (or withdrawal) including $ ______ [4515] value of qualified securities		4520
25. New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including $ ______ [4525] value of qualified securities	$	4530
26. Date of deposit (MMDDYY)		4540
	OMIT PENNIES	

FREQUENCY OF COMPUTATION

27. Daily ______ [4332] Weekly ______ [4333] Monthly ______ [4334]

**In the event the Net Capital Requirement is computed under the alternative method, this "Reserve Formula" shall be prepared in accordance with the requirements of paragraph (f) of Rule 15c3-1.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. HUTTON + COMPANY INC as of January 3, 1985

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS FOR BROKER-DEALERS UNDER RULE 15c3-3 (continued)

EXEMPTIVE PROVISIONS

28. If an exemption from Rule 15c3-3 is claimed, identify below the section upon which such exemption is based (check one only)

A. (k) (1)—$2,500 capital category as per Rule 15c3-1 .... ______ 4550

B. (k) (2)(A)—"Special Account for the Exclusive Benefit of customers" maintained .... ______ 4560

C. (k) (2)(B)—All customer transactions cleared through another broker-dealer on a fully disclosed basis. Name of clearing firm ______ 4335 ______ 4570

D. (k) (3)—Exempted by order of the Commission .... ______ 4580

Information for Possession or Control Requirements Under Rule 15c3-3

State the market valuation and the number of items of:

1. Customers' fully paid securities and excess margin securities not in the respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frames specified under Rule 15c3-3. Notes A and B .... $ ______ 4586

   A. Number of items .... ______ 4587

2. Customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of the report date, excluding items arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3. Notes B, C and D .... $ ______ 4588

   A. Number of items .... ______ 4589

OMIT PENNIES

3. The system and procedures utilized in complying with the requirement to maintain physical possession or control of customers' fully paid and excess margin securities have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 15c3-3 .... Yes ______ 4584 No ______ 4585

NOTES

A—Do not include in item one customers' fully paid and excess margin securities required by Rule 15c 3-3 to be in possession or control but for which no action was required by the respondent as of the report date or required action was taken by respondent within the time frames specified under Rule 15c3-3.

B—State separately in response to items one and two whether the securities reported in response thereto were subsequently reduced to possession or control by the respondent.

C—Be sure to include in item two only items not arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3.

D—Item two must be responded to only with report which is filed as of the date selected for the broker's or dealer's annual audit of financial statements, whether or not such date is the end of a calendar quarter. The response to item two should be filed within 60 calendar days after such date, rather than with the remainder of this report. This information may be required on a more frequent basis by the Commission or the designated examining authority in accordance with Rule 17a-5(a)(2)(iv).

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. HUTTON & COMPANY INC as of JAN 31 1985

SCHEDULE OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION

CUSTOMERS' REGULATED COMMODITY FUTURES ACCOUNTS

SEGREGATION REQUIREMENTS

1. Net ledger balance		
a. Cash	$ 133 219 000	7010
b. Securities (at market)	190 421 000	7020
2. Net unrealized profit (loss) in open futures contracts	(15 288 000)	7030
3. Net equity (Deficit) (Total of 1 - plus or minus 2)	308 352 000	7040
4. Add: accounts liquidating to a deficit and accounts with debit balances with no open trades	21 152 000	7050
5. Amount required to be segregated (Total of 3 & 4)	$ 329 504 000	7060

FUNDS ON DEPOSIT IN SEGREGATION

6. Deposited in segregated funds bank accounts:		
a. Cash	118 983 000	7070
b. Securities representing investments of customers' funds (at market)	-0-	7080
c. Securities held for customers in lieu of cash margins (at market)	190 421 000	7090
7. Margins on deposit with clearing organizations of contract markets:		
a. Cash	21 869 000	7100
b. Securities representing investments of customers' funds (at market)	21 029 000	7110
c. Securities held for customers in lieu of cash margins (at market)	-0-	7120
8. Settlement due from (to) contract market clearing organization	(9 506 000)	7130
9. Net equities with other FCMs	6 000	7140
10. Segregated funds on hand:		
a. Cash	-0-	7150
b. Securities representing investments of customers' funds (at market)	-0-	7160
c. Securities held for customers in lieu of cash margins (at market)	-0-	7170
11. Total amount in segregation (Total of 6 through 10)	$ 342 800 000	7180
12. Excess funds (insufficiency) in segregation (11 minus 5)	$ 13 296 000	7190

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E.F. HUTTON & Company Inc as of January 31, 1985

Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, (as defined below), which have not been deducted in the computation of Net Capital.

Type of Proposed withdrawal or Accrual See below for code to enter		Name of Lender or Contributor		Insider or Outsider? (In or Out)		Amount to be Withdrawn (cash amount and/or Net Capital Value of Securities)		(MMDDYY) Withdrawal or Maturity Date		Expect to Renew (yes or no)	
2	4600	FIRST INTERSTATE BANK	4601	OUT	4602	$ 1000 000	4603	3/31/85	4604	no	4605
2	4610	FIRST INTERSTATE BA..	4611	OUT	4612	1000 000	4613	6/30/85	4614	no	4615
	4620		4621		4622		4623		4624		4625
	4630		4631		4632		4633		4634		4635
	4640		4641		4642		4643		4644		4645
	4650		4651		4652		4653		4654		4655
	4660		4661		4662		4663		4664		4665
	4670		4671		4672		4673		4674		4675
3	4680		4681		4682	1800 000	4683		4684		4685
5	4690		4691		4692	20303 000	4693		4694		4695

TOTAL $ 24103 000 4699*

OMIT PENNIES

*To agree with the total on Recap (Item No. 4880)

Instructions: Detail listing must include the total of items maturing during the six month period following the report date, regardless of whether or not the capital contribution is expected to be renewed. The schedule must also include proposed capital withdrawals scheduled within the six month period following the report date including the proposed redemption of stock and payments of liabilities secured by fixed assets (which are considered allowable assets in the capital computation pursuant to Rule 15c3-1(c)(2)(iv)), which could be required by the lender on demand or in less than six months.

WITHDRAWAL CODE:	DESCRIPTION
1.	Equity Capital
2.	Subordinated Liabilities
3.	Accruals
4.	15c3-1(c)(2)(iv) Liabilities
5	AGGREGATE CREDIT EXTENSION TO CUSTOMERS ON RESTRICTED SECURITIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
Capital Withdrawals
PART II

BROKER OR DEALER E.F. Hutton & Company Inc. For the period (MMDDYY) from January 1, 1985 to January 31, 1985

RECAP

Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, which have not been deducted in the computation of net capital.

1. **Equity Capital**		
A. Partnership Capital:		
1. General Partners	$	4700
2. Limited		4710
3. Undistributed Profits		4720
4. Other (describe below)		4730
5. Sole Proprietorship		4735
B. Corporation Capital:		
1. Common Stock		4740
2. Preferred Stock		4750
3. Retained Earnings (Dividends and Other)		4760
4. Other (describe below)		4770
2. **Subordinated Liabilities**		
A. Secured Demand Notes		4780
B. Cash Subordinations		4790
C. Debentures	2000 000	4800
D. Other (describe below)		4810
3. **Other Anticipated Withdrawals**		
A. Bonuses	1800000	4820
B. Voluntary Contributions to Pension or Profit Sharing Plans		4860
C. Other (describe below)	20 303 000	4870
Total	$ 24 103 000	4880

4. **Description of Other**

Aggregate credit extended to customers on restricted accounts

STATEMENT OF CHANGES IN OWNERSHIP EQUITY (SOLE PROPRIETORSHIP, PARTNERSHIP OR CORPORATION)

1. Balance, beginning of period			$ 463 434 —	4240
A. Net income (loss)			13 345 —	4250
B. Additions (Includes non-conforming capital of	$	4262	) —	4260
C. Deductions (Includes non-conforming capital of	$	4272	) —	4270
2. Balance, end of period (From item 1800)			$ 476 779 —	4290

STATEMENT OF CHANGES IN LIABILITIES SUBORDINATED TO CLAIMS OF GENERAL CREDITORS

3. Balance, beginning of period	$ 143 983 000	4300
A. Increases		4310
B. Decreases	( )	4320
4. Balance, end of period (From item 3520)	$ 145 683 000	4330

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART I (OR PART II)

BROKER OR DEALER E. F. Hutton & Company Inc. as of 1-31-85

FINANCIAL AND OPERATIONAL DATA
Operational Deductions From Capital (Note A)

	I No. of Items		II Debits (Short Value)		III Credits (Long Value)		IV Deductions In Computing Net Capital	
1. Money suspense and balancing differences		5610	$	5810	$	6010	$ -0-	6012
2. Security suspense and differences with related money balances L		5620		5820		6020	408,000	6022
S		5625		5821		6025	-0-	6027
3. Market value of short and long security suspense and differences without related money (other than reported in line 4., below)		5630		5830		6030	806,000	6032
4. Market value of security record breaks		5640		5840		6040	-0-	6042
5. Unresolved reconciling differences with others: A. Correspondents and Broker/Dealers L		5650		5850		6050	-0-	6052
S		5655		5855		6055	-0-	6057
B. Depositories		5660		5860		6060	-0-	6062
C. Clearing Organizations L		5670		5870		6070	-0-	6072
S		5675		5875		6075	-0-	6077
D. Inter-company Accounts		5680		5880		6080	-0-	6082
E. Bank Accounts and Loans		5690		5890		6090	205,000	6092
F. Other		5700		5900		6100	-0-	6102
G. (Offsetting) Items A. through F.		5720	( )	5920	( )	6120	▨	▨
TOTAL Line 5.		5730		5930		6130	205,000	6132
6. Commodity Differences		5740		5940		6140	-0-	6142
7. Open transfers and reorganization account items over 40 days not confirmed or verified		5760		5960		6160	-0-	6162
8. TOTAL (Lines 1.-7.)		5770	$	5970	$	6170	$ 1,419,000	6172
9. Lines 1.-8. resolved subsequent to report date		5775	$	5975	$	6175	$	6177
10. Aged Fails—to deliver	610	5780	$ 26,913	5980	$ 30,369	6180	$ 225,000	6182
—to receive	224	5785	$ 25,956	5985	$ 25,591	6185	$ 2,517,000	6187
			(Omit 000's)		(Omit 000's)		(Omit Pennies)	

NOTE A—This section must be completed as follows:

1. All member organizations must complete column IV, lines 1. through 8. and 10., reporting deductions from capital as of the report date whether resolved subsequently or not (see instructions relative to each line item).
2. a. Columns I, II and III of lines 1. through 8. and 10. must be completed when a Part II filing is required.
   b. Columns I, II and III of lines 1. through 8. must be completed with a Part I filing, only if the total deduction on line 8. column IV equals or exceeds 25% of excess net capital as of the prior month end reporting date. All columns of line 10. require completion.
3. A response to line 9., cols. I through IV and the "Potential Operational Charges Not Deducted From Capital" schedule on p. 3 are required only if:
   a. the parameters cited in 2.b. above exist; and
   b. the total deduction, line 8. column IV, for the current month exceeds the total deductions for the prior month by 50% or more.
4. All columns and line items (1. through 10.) must be answered if required. If respondent has nothing to report enter -0-.

……………………

Other Operational Data (Items 1., 2. and 3. below require an answer)

Item 1. Have the accounts enumerated on lines 5.A. through F. above been reconciled with statements received from others within 35 days for lines 5.A through D. and 65 days for lines 5.E. and F. prior to the report date and have all reconciling differences been appropriately comprehended in the computation of net capital at the report date? If this has not been done in all respects, answer No.

Yes X 5600
No ___ 5601

Item 2. Do the respondent's books reflect a concentrated position (See instruction) in commodities? If Yes report the totals ($000 omitted) in accordance with the specific instructions; if No answer -0- for:

A. Firm Trading and Investment Accounts
B. Customers' and Non-Customers' and Other Accounts

A. -0- 5602
B. -0- 5603

Item 3. Does respondent have any planned operational or organizational changes? (Answer Yes or No based on specific instructions.)

Yes ___ 5604
No X 5605

FORM
-17A-5

4/81

FOCUS REPORT

(Financial and Operational Combined Uniform Single Report)

PART I OR PART II

☒ 10 ☐ 11

(Read instructions before preparing Form)

The report is being filed pursuant to (Check Applicable Block(s)):

1) Rule 17a-5(a) ☒ 16 2) Rule 17a-5(b) ☐ 17 3) Rule 17a-11 ☐ 18

4) Special request by designated examining authority ☐ 19 5) Other ☐ 26

OF BROKER-DEALER

E. F. Hutton & Company Inc. 13

SEC FILE NO. 14

FOR FIRM ID. NO. 13-937069 15

ESS OF PRINCIPAL PLACE OF BUSINESS (Do not use P.O. Box No.)

One Battery Park Plaza 20
(No. and Street)

New York 21 New York 22 10004 23
(City) (State) (Zip)

FOR PERIOD BEGINNING (MM/DD/YY) January 1, 1985 24

AND ENDING (MM/DD/YY) January 31, 1985 25

AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Michael P. Castellano 30 (212) 742-3546 31
(Area Code—Telephone No.)

(S) OF SUBSIDIARIES OR AFFILIATES CONSOLIDATED IN THIS REPORT
SUANT TO APPENDIX C OF RULE 15C3-1

		CHECK IF GUARANTEED		CHECK IF FLOW THROUGH	
E. F. Hutton International Inc.	32	X	80		33
	34		81		35
	36		82		37
	38		83		39

DOES RESPONDENT CARRY ITS OWN CUSTOMER ACCOUNTS? YES ☒ 40 NO ☐ 41

DOES RESPONDENT CLEAR TRANSACTIONS? YES ☒ 43 NO ☐ 44

CHECK HERE IF RESPONDENT IS FILING AN AUDITED REPORT ☐ 42

EXECUTION:

The registrant/broker or dealer submitting this Form and its attachments and the person(s) by whom it is executed represent hereby that all information contained therein is true, correct and complete. It is understood that all required items, statements, and schedules are considered integral parts of this Form and that the submission of any amendment represents that all unamended items, statements and schedules remain true, correct and complete as previously submitted. See generel instructions for reporting contractural and contingent liabilities.

Dated the 26th day of February 19 85

Manual Signatures of

1) Principal Executive Officer or Managing Partner

2) Principal Financial Officer or Partner

3) Principal Operations Officer or Partner

ATTENTION— Intentional misstatements or omissions of facts constitute Federal Criminal Violations. (See 18 U.S.C. 1001 and 15 U.S.C. 78f (a).)

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT

PART I
FOCUS REPORT

BROKER — DEALER
E. F. Hutton & Company Inc.

N 1
For Current Month

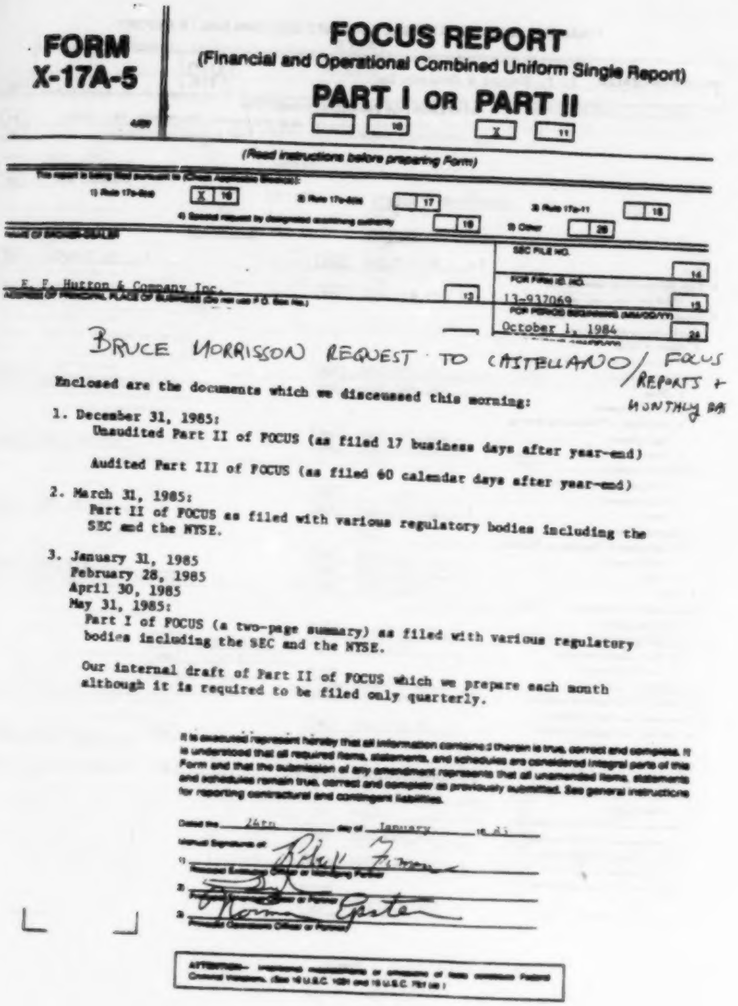
AS OF (MMDDYY)
January 31, 1985

SEC FILE NO.

ITEM
100
99
98

	ITEM	(OMIT PENNIES)	
1.	Subordinated Loan Agreements—Cash	145,683,000	1710
2.	Secured Demand Notes—Face Amount	–	1730
3.	Total Subordinations Allowable for Net Capital	145,683,000	3520
4.	Ownership Equity/Partnership Capital—Beginning of Month	463,434,000	3601
5.	Unconsolidated Income/Expense for the Month:		
	a. Trading and Investment Account Profit or (Loss)	39,897,000	3851
	b. Other Gross Income (Loss)	176,398,000	4212
	c. Expenses	193,536,000	4801
	d. Federal Income Taxes	9,414,000	4221
6.	Net Profit or (Loss) for the Month	13,345,000	4250
7.	Other (Exclude Non-Conforming Capital)		
	a. Additions to Capital	–	4264
	b. Deductions from Capital	–	4274
8.	Ownership Equity/Partnership Capital—End of Month	476,779,000	3500
9.	Other (Deductions) or Allowable Credits	–	3525
10.	Total Capital and Allowable Subordinations	622,462,000	3530
	Deductions and/or Charges to Capital		
11.	Added Charges Customer and Non-Customer		
	a. Security Accounts	3,414,000	3550
	a. Commodity Accounts	1,893,000	3560
12.	Operational Deductions from Capital (Page 2 Line 8 Col. IV)	1,419,000	3575
13.	Non-Allowable Assets (Not Includable Above)	332,912,000	3541
14.	Proprietary Charges on Commodities	239,000	3600
15.	Other Charges and/or Deductions	3,711,000	3612
16.	Total Deductions and/or Charges (Lines 11 thru 15)	343,588,000	3620
17.	Net Capital—Before Haircuts on Securities	278,874,000	3640
18.	Haircuts on Proprietary Security Positions (Including Contractual Commitments)	104,946,000	3740
19.	Net Capital	173,928,000	3750
20.	Scheduled Capital Withdrawals Within 6 Months	24,103,000	4880
21.	Net Capital After Withdrawals	149,825,000	4881
22.	Total Equity Subordinations	–	1011
23.	a. Aggregate Indebtedness under SEC Rule 15c3-1	–	3840
	b. Aggregate Debits under SEC Rule 15c3-3 as Adjusted	1,827,377,000	4470
24.	Minimum Net Capital Required	36,573,000	3760
25.	Ratios/Excess Net Capital		
	a. Aggregate Indebtedness to Net Capital	% –	3850
	b. Net Capital to Aggregate Debit Items	% 9.52	3851
	c. Net Capital in Excess of Greater of 6 2/3% of AI or Minimum	–	3770
	d. Net Capital in Excess of Greater of 2% of ADI or Minimum	137,355,000	3910
	e. Option Deductions/Net Capital Ratio	% –	3852
26.	Total Credits—Rule 15c3-3 Reserve Formula	1,727,762,000	4430
27.	Total Debits—Rule 15c3-3 Reserve Formula—Net	1,727,629,000	4472
28.	Amount in Reserve Bank Account	–	4530
29.	Commodity Exchange Act—Segregation Requirement		
	a. Amount Required to be Segregated	329,506,000	7085
	b. Amount Segregated	342,800,000	7180
30.	Firm Proprietary Positions		
	a. Long—Contractual Commitments—Certain Exempt Securities	2,233,001,000	841
	b. Short—Contractual Commitments—Certain Exempt Securities	2,293,803,000	1621
31.	Customer and Non-Customer Charges—Certain Exempt Securities	–	3461
32.	a. Security Concentration—Firm	–	3371
	b. Security Concentration—Customer	–	3372
33.	Total Tickets	1,101,128	4882
34.			
35.			
36.			
37.			
38.			
39.			

4/81



FORM X-17A-5

FOCUS REPORT

(Financial and Operational Combined Uniform Single Report)

PART I OR PART II

☐ 10 ☒ 11

(Read instructions before preparing Form)

This report is being filed pursuant to (Check Applicable Block(s)):

1) Rule 17a-5(a) ☒ 16 2) Rule 17a-5(b) ☐ 17 3) Rule 17a-11 ☐ 18

4) Special request by designated examining authority ☐ 19 5) Other ☐ 26

NAME OF BROKER-DEALER

E. F. Hutton & Company Inc. 13

ADDRESS OF PRINCIPAL PLACE OF BUSINESS (Do not use P.O. Box No.)

SEC FILE NO. 14

FOR FIRM ID. NO. 13-937069 15

FOR PERIOD BEGINNING (MM/DD/YY) October 1, 1984 24

BRUCE MORRISSON REQUEST TO CASTELLANO/ FOCUS REPORTS + MONTHLY BA

Enclosed are the documents which we discussed this morning:

1. December 31, 1985:
   Unaudited Part II of FOCUS (as filed 17 business days after year-end)

   Audited Part III of FOCUS (as filed 60 calendar days after year-end)

2. March 31, 1985:
   Part II of FOCUS as filed with various regulatory bodies including the SEC and the NYSE.

3. January 31, 1985
   February 28, 1985
   April 30, 1985
   May 31, 1985:
   Part I of FOCUS (a two-page summary) as filed with various regulatory bodies including the SEC and the NYSE.

   Our internal draft of Part II of FOCUS which we prepare each month although it is required to be filed only quarterly.

[illegible] it is executed represent hereby that all information contained therein is true, correct and complete. It is understood that all required items, statements, and schedules are considered integral parts of this Form and that the submission of any amendment represents that all unamended items, statements and schedules remain true, correct and complete as previously submitted. See general instructions for reporting contractual and contingent liabilities.

Dated the 24th day of January 19 85

Manual Signatures of:

1) Principal Executive Officer or Managing Partner

2) Principal Financial Officer or Partner

3) Principal Operations Officer or Partner

ATTENTION— Intentional misstatements or omissions of facts constitute Federal Criminal Violations. (See 18 U.S.C. 1001 and 15 U.S.C. 78f (a))

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER	E. F. Hutton & Company Inc.	N	2			100

STATEMENT OF FINANCIAL CONDITION

As of (MM/DD/YY) December 31, 1984 [20]
SEC FILE NO. ______ [98]

Consolidated ☒ [198]
Unconsolidated ☐ [199]

ASSETS

	Allowable		Nonallowable		Total	
1. Cash	$ 30,513,000	200			$ 30,513,000	750
2. Cash segregated in compliance with federal and other regulations	99,823,000	210			99,823,000	760
3. Receivable from brokers or dealers and clearing organizations:						
A. Failed to deliver:						
1. Includable in "Formula for Reserve Requirements"	25,995,000	220				
2. Other	582,645,000	230			608,640,000	770
B. Securities borrowed:						
1. Includable in "Formula for Reserve Requirements"	121,567,000	240				
2. Other	616,374,000	250			737,941,000	780
C. Omnibus accounts:						
1. Includable in "Formula for Reserve Requirements"	-0-	260				
2. Other	27,295,000	270			27,295,000	790
D. Clearing organizations:						
1. Includable in "Formula for Reserve Requirements"	114,000	280				
2. Other	37,785,000	290			37,899,000	800
E. Other	90,456,000	300	$ -0-	550	90,456,000	810
4. Receivables from customers:						
A. Securities accounts:						
1. Cash and fully secured accounts	2,097,792,000	310				
2. Partly secured accounts	353,000	320	108,000	560		
3. Unsecured accounts			11,918,000	570		
B. Commodity accounts	59,732,000	330	26,259,000	580		
C. Allowance for doubtful accounts	(-0-)	335	(30,616,000)	590	2,165,546,000	820
5. Receivables from non-customers:						
A. Cash and fully secured accounts	16,661,000	340				
B. Partly secured and unsecured accounts	-0-	350	-0-	600	16,661,000	830
6. Securities purchased under agreements to resell	6,646,671,000	360	-0-	605	6,646,671,000	840
7. Securities and spot commodities owned, at market value:						
A. Bankers acceptances, certificates of deposit and commercial paper	739,983,000	370				
B. U.S. and Canadian government obligations	1,300,910,000	380				
C. State and municipal government obligations	1,167,225,000	390				
D. Corporate obligations	356,078,000	400				

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of December 31, 1984

STATEMENT OF FINANCIAL CONDITION

ASSETS

	Allowable	Nonallowable	Total
E. Stocks and warrants	$ 362,073,000 [418]		
F. Options	13,763,000 [420]		
G. Arbitrage	-0- [422]		
H. Other securities	21,986,000 [424]		
I. Spot commodities	-0- [430]		$ 3,942,068,000 [850]
8. Securities owned not readily marketable:			
A. At Cost $ [130]			
B. At estimated fair value	-0- [440]	$ -0- [610]	-0- [860]
9. Other investments not readily marketable:			
A. At Cost $ 1,920,000 [140]			
B. At estimated fair value	[450]	1,609,000 [620]	1,609,000 [870]
10. Securities borrowed under subordination agreements and partners' individual and capital securities accounts, at market value:			
A. Exempted securities $ -0- [150]			
B. Other $ -0- [160]	-0- [460]	-0- [630]	-0- [880]
11. Secured demand notes-market value of collateral:			
A. Exempted securities $ -0- [170]			
B. Other $ -0- [180]	-0- [470]	-0- [640]	-0- [890]
12. Memberships in exchanges:			
A. Owned, at market value $ 12,370,000 [190]			
B. Owned at cost		4,950,000 [650]	
C. Contributed for use of company, at market value		-0- [660]	4,950,000 [900]
13. Investment in and receivables from affiliates, subsidiaries and associated partnerships	-0- [480]	3,581,000 [670]	3,581,000 [910]
14. Property, furniture, equipment, leasehold improvements and rights under lease agreements: At cost (net of accumulated depreciation and amortization)	-0- [490]	152,499,000 [680]	152,499,000 [920]
15. Other Assets:			
A. Dividends and interest receivable	8,634,000 [500]	3,699,000 [690]	
B. Free shipments	3,939,000 [510]	500,000 [700]	
C. Loans and advances	935,000 [520]	34,583,000 [710]	
D. Miscellaneous	76,313,000 [530]	113,768,000 [720]	242,371,000 [930]
16. TOTAL ASSETS	$ 14,485,665,000 [540]	$ 322,858,000 [740]	$ 14,808,523,000 [940]

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. **as of** December 31, 1984

STATEMENT OF FINANCIAL CONDITION

LIABILITIES AND OWNERSHIP EQUITY

Liabilities	A.I. Liabilities *		Non-A.I. Liabilities *		Total	
17. Bank loans payable:						
A. Includable in "Formula for Reserve Requirements"	$	1030	$	1240	$ 454,736,000	1460
B. Other		1040		1250	703,477,000	1470
18. Securities sold under repurchase agreements				1260	7,545,041,000	1480
19. Payable to brokers or dealers and clearing organizations:						
A. Failed to receive:						
1. Includable in "Formula for Reserve Requirements"		1050		1270	26,525,000	1490
2. Other		1060		1280	113,415,000	1500
B. Securities loaned:						
1. Includable in "Formula for Reserve Requirements"		1070			246,900,000	1510
2. Other		1080		1290	388,553,000	1520
C. Omnibus accounts:						
1. Includable in "Formula for Reserve Requirements"		1090			---	1530
2. Other		1095		1300	29,968,000	1540
D. Clearing organizations:						
1. Includable in "Formula for Reserve Requirements"		1100			108,000	1550
2. Other		1105		1310	14,073,000	1560
E. Other		1110		1320	24,452,000	1570
20. Payable to customers:						
A. Securities accounts - including free credits of $810,786,000 [950]		1120			1,201,569,000	1580
B. Commodities accounts		1130		1330	166,246,000	1590
21. Payable to non-customers:						
A. Securities accounts		1140		1340	1,223,000	1600
B. Commodities accounts		1150		1350	624,000	1610
22. Securities sold not yet purchased at market value - including arbitrage of $ -0- [960]				1360	2,296,080,000	1620
23. Accounts payable and accrued liabilities and expenses:						
A. Drafts payable		1160			775,000	1630
B. Accounts payable		1170			159,658,000	1640
C. Income taxes payable		1180			24,508,000	1650
D. Deferred income taxes				1370	-0-	1660
E. Accrued expenses and other liabilities		1190			773,737,000	1670
F. Other		1200		1380	46,268,000	1680

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*Brokers or Dealers electing the alternative net capital requirement method need not complete these columns.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of December 31, 1984

STATEMENT OF FINANCIAL CONDITION

LIABILITIES AND OWNERSHIP EQUITY (continued)

Liabilities		A.I. Liabilities*	Non-A.I. Liabilities*	Total
24. Notes and mortgages payable:				
A. Unsecured		$ 1210		$ 1690
B. Secured		$ 1211	$ 1390	1700
25. Liabilities subordinated to claims of general creditors:				
A. Cash borrowings			1400	143,963,000 1710
1. from outsiders	$17,000,000 970			
2. Includes equity subordination (15c3-1 (d)) of	$ --- 980			
B. Securities borrowings, at market value: from outsiders	$ --- 990		1410	1720
C. Pursuant to secured demand note collateral agreements:			1420	$ 1730
1. from outsiders	$ --- 1000			
2. Includes equity subordination (15c3-1 (d)) of	$ --- 1010			
D. Exchange memberships contributed for use of company at market value			$ 1430	1740
E. Accounts and other borrowings not qualified for net capital purposes		1220	1440	5,370,000 1750
26. TOTAL LIABILITIES		$ 1230	$ 1450	$14,345,089,000 1760

Ownership Equity

		Total
27. Sole proprietorship		$ 1770
28. Partnership: limited partners	$ 1020	1780
29. Corporation:		
A. Preferred stock		1791
B. Common stock		$ 2,000 1792
C. Additional paid-in capital		95,914,000 1793
D. Retained earnings		367,518,000 1794
E. Total		463,434,000 1795
F. Less capital stock in treasury		( ) 1796
30. TOTAL OWNERSHIP EQUITY		$ 463,434,000 1800
31. TOTAL LIABILITIES AND OWNERSHIP EQUITY		$14,808,523,000 1810

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*Brokers or Dealers electing the alternative net capital requirement method need not complete these columns.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of December 31, 1984

COMPUTATION OF NET CAPITAL

1. Total ownership equity (from Statement of Financial Condition – Item 1800)					$ 463,434,000	3480
2. Deduct: Ownership equity not allowable for net capital					( )	3490
3. Total ownership equity qualified for net capital					463,434,000	3500
4. Add:						
A. Liabilities subordinated to claims of general creditors allowable in computation of net capital					143,983,000	3520
B. Other (deductions) or allowable credits (List)					-0-	3525
5. Total capital and allowable subordinated liabilities					$ 607,417,000	3530
6. Deductions and/or charges:						
A. Total non-allowable assets from Statement of Financial Condition (Note B and C)			$ 322,858,000	3540		
1. Additional charges for customers' and non-customers' security accounts			8,483,000	3550		
2. Additional charges for customers' and non-customers' commodity accounts			5,815,000	3560		
B. Aged fail-to-deliver			3,249,000	3570		
1. Number of items	684	3450				
C. Aged short security differences-less reserve of	$ -0-	3460	1,598,000	3580		
number of items	111	3470				
D. Secured demand note deficiency			-0-	3590		
E. Commodity futures contracts and spot commodities – proprietary capital charges			2,000	3600		
F. Other deductions and/or charges			4,786,000	3610		
G. Deductions for accounts carried under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x)			-0-	3615		
H. Total deductions and/or charges					($346,791,000)	3620
7. Other additions and/or allowable credits (List)						3630
8. Net Capital before haircuts on securities positions					$ 260,626,000	3640
9. Haircuts on securities: (computed, where applicable, pursuant to 15c3-1 (f)):						
A. Contractual securities commitments			2,466,000	3660		
B. Subordinated securities borrowings			-0-	3670		
C. Trading and investment securities:						
1. Bankers' acceptances, certificates of deposit and commercial paper			2,387,000	3680		
2. U.S. and Canadian government obligations			13,548,000	3690		
3. State and municipal government obligations			24,562,000	3700		
4. Corporate obligations			29,697,000	3710		
5. Stocks and warrants			13,143,000	3720		
6. Options			6,155,000	3730		
7. Arbitrage			-0-	3732		
8. Other securities			2,039,000	3734		
D. Undue concentration			225,000	3650		
E. Other (list)			53,000	3736	(94,275,000)	3740
10. Net Capital					$ 166,351,000	3750

OMIT PENNIES

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of December 31, 1984

COMPUTATION OF BASIC NET CAPITAL REQUIREMENT

Part A

11. Minimum net capital required (6-2/3% of line 19)			$	3756
12. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)			$	3758
13. Net capital requirement (greater of line 11 or 12)			$	3760
14. Excess net capital (line 10 less 13)			$	3770
15. Excess net capital at 1000% (line 10 less 10% of line 19)			$	3780

COMPUTATION OF AGGREGATE INDEBTEDNESS

16. Total A.I. liabilities from Statement of Financial Condition			$	3790
17. Add:				
A. Drafts for immediate credit	$	3800		
B. Market value of securities borrowed for which no equivalent value is paid or credited	$	3810		
C. Other unrecorded amounts (List)	$	3820	$	3830
18. Deduct: Adjustment based on deposits in Special Reserve Bank Accounts (15c3-1 (c) (1) (vii))			$	3838
19. Total aggregate indebtedness			$	3840
20. Percentage of aggregate indebtedness to net capital (line 19 ÷ by line 10)			%	3850
21. Percentage of Aggregate indebtedness to net capital *after* anticipated capital withdrawals (line 19 ÷ by line 10 less Item 4880 page 11)			%	3853

COMPUTATION OF ALTERNATE NET CAPITAL REQUIREMENT

Part B

22. 2% of combined aggregate debit items as shown in Formula for Reserve Requirements pursuant to Rule 15c3-3 prepared as of the date of the net capital computation including both brokers or dealers and consolidated subsidiaries' debits	$ 40,118,000	3870
23. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)	$ 40,143,000	3880
24. Net capital requirement (greater of line 22 or 23)	$ 40,143,000	3760
25. Excess net capital (line 10 less 24)	$126,208,000	3910
26. Percentage of Net Capital to Aggregate Debits (line 10 ÷ by line 17 page 8)	% 8.29	3851
27. Percentage of Net Capital, *after* anticipated capital withdrawals, to Aggregate Debits (line 10 less Item 4880 page 11 ÷ by line 17 page 8)	% 7.03	3854
28. Net capital in excess of the greater of:		
A. 4% of combined aggregate debit items or $120,000	$ 86,064,000	3920
B. 5% of combined aggregate debit items or $120,000	$ 65,993,000	3930

OTHER RATIOS

Part C

29. Percentage of debt to debt-equity total computed in accordance with Rule 15c3-1 (d)	% 23.70	3860
30. Options deductions/Net Capital ratio (1000% test) total deductions exclusive of liquidating equity under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x) ÷ Net Capital	%	3852

NOTES:

(A) The minimum net capital requirement should be computed by adding the minimum dollar net capital requirement of the reporting broker dealer and, for each subsidiary to be consolidated, the greater of:
1. Minimum dollar net capital requirement, or
2. 6-2/3% of aggregate indebtedness or 4% of aggregate debits if alternative method is used.

(B) Do not deduct the value of securities borrowed under subordination agreements or secured demand notes covered by subordination agreements not in satisfactory form and the market values of memberships in exchanges contributed for use of company (contra to item 1740) and partners' securities which were included in non-allowable assets.

(C) For reports filed pursuant to paragraph (d) of Rule 17a-5, respondent should provide a list of material non-allowable assets.

PART II—FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT

BROKER OR DEALER	For the period (MMDDYY) from		to	
E. F. Hutton & Company Inc.	Oct. 1, 1984	3932	Dec.31,'84	3933
	Number of months included in this statement	3		3931

STATEMENT OF INCOME (LOSS)

REVENUE				
1. Commissions:				
a. Commissions on transactions in listed equity securities executed on an exchange			$ 62,319,000	3935
b. Commissions on transactions in exchange listed equity securities executed over-the-counter			-0-	3937
c. Commissions on listed option transactions			16,077,000	3938
d. All other securities commissions			8,342,000	3939
e. Total securities commissions			86,738,000	3940
2. Gains or losses on firm securities trading accounts				
a. From market making in over-the-counter equity securities			12,599,000	3941
i. Includes gains or (losses) OTC market making in exchange listed equity securities	-0-	3943		
b. From trading in debt securities			111,022,000	3944
c. From market making in options on a national securities exchange			-0-	3945
d. From all other trading			(1,116,000)	3949
e. Total gains or (losses)			122,505,000	3950
3. Gains or losses on firm securities investment accounts				
a. Includes realized gains (losses)	(125,000)	4235		
b. Includes unrealized gains (losses)	187,000	4236		
c. Total realized and unrealized gains (losses)			62,000	3952
4. Profits or (losses) from underwriting and selling groups			45,875,000	3955
a. Includes underwriting income from corporate equity securities	3,569,000	4237		
5. Margin interest			37,533,000	3960
6. Revenue from sale of investment company shares			14,476,000	3970
7. Fees for account supervision, investment advisory and administrative services			14,520,000	3975
8. Revenue from research services			-0-	3980
9. Commodities revenue			27,401,000	3990
10. Other revenue related to securities business			188,569,000	3985
11. Other revenue			22,526,000	3995
12. Total revenue			$ 560,205,000	4030
EXPENSES				
13. Registered representatives' compensation			$ 149,643,000	4110
14. Clerical and administrative employees' expenses			46,985,000	4040
15. Salaries and other employment costs for general partners, and voting stockholder officers			21,661,000	4120
a. Includes interest credited to General and Limited Partners capital accounts	-0-	4130		
16. Floor brokerage paid to certain brokers (see definition)			1,769,000	4055
17. Commissions and clearance paid to all other brokers (see definition)			1,586,000	4145
18. Clearance paid to non-brokers (see definition)			2,947,000	4135
19. Communications			33,702,000	4060
20. Occupancy and equipment costs			30,458,000	4080
21. Promotional costs			15,445,000	4150
22. Interest expense			187,326,000	4075
a. Includes interest on accounts subject to subordination agreements	576,000	4070		
23. Losses in error account and bad debts			17,398,000	4170
24. Data processing costs (including service bureau service charges)			4,463,000	4186
25. Non-recurring charges			-0-	4190
26. Regulatory fees and expenses			1,096,000	4195
27. Other expenses			27,446,000	4100
28. Total expenses			$ 541,925,000	4200
NET INCOME				
29. Income (loss) before Federal income taxes and items below (Item 12 less Item 28)			$ 18,280,000	4210
30. Provision for Federal income taxes (for parent only)			3,238,000	4220
31. Equity in earnings (losses) of unconsolidated subsidiaries not included above			1,579,000	4222
a. After Federal income taxes of	-0-	4238		
32. Extraordinary gains (losses)			-0-	4224
a. After Federal income taxes of	-0-	4239		
33. Cumulative effect of changes in accounting principles			-0-	4225
34. Net income (loss) after Federal income taxes and extraordinary items			$ 16,621,000	4230
MONTHLY INCOME				
35. Income (current month only) before provision for Federal income taxes and extraordinary items			$ (3,779,000)	4211

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. **as of** December 31, 1984

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS FOR BROKER-DEALERS UNDER RULE 15c3-3
(See Rule 15c3-3, Exhibit A and Related Notes)

CREDIT BALANCES

1. Free credit balances and other credit balances in customers' security accounts (see Note A, Exhibit A, Rule 15c3-3)	$1,061,519,000	4340		
2. Monies borrowed collateralized by securities carried for the accounts of customers (see Note B)	89,500,000	4350		
3. Monies payable against customers' securities loaned (see Note C)	242,962,000	4360		
4. Customers' securities failed to receive (see Note D)	92,027,000	4370		
5. Credit balances in firm accounts which are attributable to principal sales to customers	346,720,000	4380		
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days	49,000	4390		
7. **Market value of short security count differences over 30 calendar days old	72,000	4400		
8. **Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days	3,721,000	4410		
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days	4,243,000	4420		
10. Other (List)	---	4425		
11. TOTAL CREDITS			$1,840,813,000	4430

DEBIT BALANCES

12. **Debit balances in customers' cash and margin accounts excluding unsecured accounts and accounts doubtful of collection net of deductions pursuant to Note E, Exhibit A, Rule 15c3-3	$1,793,407,000	4440		
13. Securities borrowed to effectuate short sales by customers and securities borrowed to make delivery on customers' securities failed to deliver	121,567,000	4450		
14. Failed to deliver of customers' securities not older than 30 calendar days	90,943,000	4460		
15. Margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in customer accounts (See Note F)	---	4465		
16. Other (List)	---	4469		
17. **Aggregate debit items			$2,005,917,000	4470
18. **less 3% (for alternative method only — see Rule 15c3-1 (f) (5) (i))			(60,178,000)	4471
19. **TOTAL 15c3-3 DEBITS			$1,945,739,000	4472

RESERVE COMPUTATION

20. Excess of total debits over total credits (line 19 less line 11)	$104,926,000	4480
21. Excess of total credits over total debits (line 11 less line 19)		4490
22. If computation permitted on a monthly basis, enter 105% of excess of total credits over total debits		4500
23. Amount held on deposit in "Reserve Bank Account(s)", including value of qualified securities, at end of reporting period		4510
24. Amount of deposit (or withdrawal) including $ 30,000,000 [4515] value of qualified securities	30,000,000	4520
25. New amount in Reserve Ba... Account(s) after adding deposit or subtracting withdrawal including $ [4525] value of qualified securities	$	4530
26. Date of deposit (MMDDYY)	01-03-85	4540

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FREQUENCY OF COMPUTATION

27. Daily ____ [4332] Weekly X [4333] Monthly ____ [4334]

**In the event the Net Capital Requirement is computed under the alternative method, this "Reserve Formula" shall be prepared in accordance with the requirements of paragraph (f) of Rule 15c3-1

READEX FICHE

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of December 31, 1984

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS FOR BROKER-DEALERS UNDER RULE 15c3-3 (continued)

EXEMPTIVE PROVISIONS

28. If an exemption from Rule 15c3-3 is claimed, identify below the section upon which such exemption is based (check one only)

A. (k) (1)—$2,500 capital category as per Rule 15c3-1 .... ______ 4550

B. (k) (2)(A)—"Special Account for the Exclusive Benefit of customers" maintained .... ______ 4560

C. (k) (2)(B)—All customer transactions cleared through another broker-dealer on a fully disclosed basis. Name of clearing firm ______ 4335 ______ 4570

D. (k) (3)—Exempted by order of the Commission .... ______ 4580

Information for Possession or Control Requirements Under Rule 15c3-3

State the market valuation and the number of items of:

1. Customers' fully paid securities and excess margin securities not in the respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frames specified under Rule 15c3-3. Notes A and B .... $ ______ 4586

   A. Number of items .... ______ 4587

2. Customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of the report date, excluding items arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3. Notes B, C and D .... $ -0- 4588

   A. Number of items .... -0- 4589

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3. The system and procedures utilized in complying with the requirement to maintain physical possession or control of customers' fully paid and excess margin securities have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 15c3-3 .... Yes X 4584 No ______ 4585

NOTES

A—Do not include in item one customers' fully paid and excess margin securities required by Rule 15c 3-3 to be in possession or control but for which no action was required by the respondent as of the report date or required action was taken by respondent within the time frames specified under Rule 15c3-3.

B—State separately in response to items one and two whether the securities reported in response thereto were subsequently reduced to possession or control by the respondent.

C—Be sure to include in item two only items not arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3.

D—Item two must be responded to only with report which is filed as of the date selected for the broker's or dealer's annual audit of financial statements, whether or not such date is the end of a calendar quarter. The response to item two should be filed within 60 calendar days after such date, rather than with the remainder of this report. This information may be required on a more frequent basis by the Commission or the designated examining authority in accordance with Rule 17a-5(a)(2)(iv).

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FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of December 31, 1984

SCHEDULE OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION

CUSTOMERS' REGULATED COMMODITY FUTURES ACCOUNTS

SEGREGATION REQUIREMENTS

1. Net ledger balance		
a. Cash	$ 121,102,000	7010
b. Securities (at market)	187,805,000	7020
2. Net unrealized profit (loss) in open futures contracts	(28,915,000)	7030
3. Net equity (Deficit) (Total of 1 - plus or minus 2)	279,992,000	7040
4. Add: accounts liquidating to a deficit and accounts with debit balances with no open trades	17,914,000	7050
5. Amount required to be segregated (Total of 3 & 4	$ 297,906,000	7060

FUNDS ON DEPOSIT IN SEGREGATION

6. Deposited in segregated funds bank accounts:		
a. Cash	99,634,000	7070
b. Securities representing investments of customers' funds (at market)		7080
c. Securities held for customers in lieu of cash margins (at market)	187,805,000	7090
7. Margins on deposit with clearing organizations of contract markets:		
a. Cash	16,920,000	7100
b. Securities representing investments of customers' funds (at market)	11,344,000	7110
c. Securities held for customers in lieu of cash margins (at market)		7120
8. Settlement due from (to) contract market clearing organization	(1,745,000)	7130
9. Net equities with other FCMs		7140
10. Segregated funds on hand:		
a. Cash		7150
b. Securities representing investments of customers' funds (at market)		7160
c. Securities held for customers in lieu of cash margins (at market)		7170
11. Total amount in segregation (Total of 6 through 10)	$ 313,958,000	7180
12. Excess funds (insufficiency) in segregation (11 minus 5)	$ 16,052,000	7190

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of December 31, 1984

Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, (as defined below), which have not been deducted in the computation of Net Capital.

Type of Proposed withdrawal or Accrual See below for code to enter		Name of Lender or Contributor		Insider or Outsider? (In or Out)		Amount to be Withdrawn (cash amount and/or Net Capital Value of Securities)		(MMDDYY) Withdrawal or Maturity Date		Expect to Renew (yes or no)	
2	4600	First Interstate Ba	4601	Out	4602	$ 1,000,000	4603	3/31/85	4604	No	4605
2	4610	First Interstate Ba	4611	Out	4612	1,000,000	4613	6/30/85	4614	No	4615
	4620		4621		4622		4623		4624		4625
	4630		4631		4632		4633		4634		4635
	4640		4641		4642		4643		4644		4645
	4650		4651		4652		4653		4654		4655
	4660		4661		4662		4663		4664		4665
	4670		4671		4672		4673		4674		4675
2	4680		4681		4682	1,800,000	4683		4684		4685
5	4690		4691		4692	21,574,000	4693		4694		4695
					TOTAL	$ 25,374,000	4699*				

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*To agree with the total on Recap (Item No. 4699)

Instructions: Detail listing must include the total of items maturing during the six month period following the report date, regardless of whether or not the capital contribution is expected to be renewed. The schedule must also include proposed capital withdrawals scheduled within the six month period following the report date including the proposed redemption of stock and payments of liabilities secured by fixed assets (which are considered allowable assets in the capital computation pursuant to Rule 15c3-1(c)(2)(iv)), which could be required by the lender on demand or in less than six months.

WITHDRAWAL CODE:	DESCRIPTION
1.	Equity Capital
2.	Subordinated Liabilities
3.	Accruals
4.	15c3-1(c)(2)(iv) Liabilities
5.	Aggregate credit extended to customers on restricted securities

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
Capital Withdrawals
PART II

BROKER OR DEALER E. F. Hutton & Company Inc.

For the period (MMDDYY) from October 1, 1984 to December 31, 198

RECAP

Ownership Equity and Subordinated Liabilities maturing or proposed to be withdrawn within the next six months and accruals, which have not been deducted in the computation of net capital.

1. **Equity Capital**				
A. Partnership Capital:				
1. General Partners	$	4700		
2. Limited		4710		
3. Undistributed Profits		4720		
4. Other (describe below)		4730		
5. Sole Proprietorship		4735		
B. Corporation Capital:				
1. Common Stock		4740		
2. Preferred Stock		4750		
3. Retained Earnings (Dividends and Other)		4760		
4. Other (describe below)		4770		
2. **Subordinated Liabilities**				
A. Secured Demand Notes		4780		
B. Cash Subordinations	3,800,000	4790		
C. Debentures		4800		
D. Other (describe below)		4810		
3. **Other Anticipated Withdrawals**				
A. Bonuses		4820		
B. Voluntary Contributions to Pension or Profit Sharing Plans		4860		
C. Other (describe below)	21,574,000	4870		
Total			$ 25,374,000	4880

4. **Description of Other**

3.C. Aggregate credit extended to customers on restricted securities.

STATEMENT OF CHANGES IN OWNERSHIP EQUITY (SOLE PROPRIETORSHIP, PARTNERSHIP OR CORPORATION)

1. Balance, beginning of period			$ 431,813,000	4240
A. Net income (loss)			16,621,000	4250
B. Additions (Includes non-conforming capital of	$	4262	) 40,000,000	4260
C. Deductions (Includes non-conforming capital of	$	4272	) 25,000,000	4270
2. Balance, end of period (From item 1800)			$ 463,434,000	4290

STATEMENT OF CHANGES IN LIABILITIES SUBORDINATED TO CLAIMS OF GENERAL CREDITORS

3. Balance, beginning of period	$ 139,453,000	4300
A. Increases	7,474,000	4310
B. Decreases	(2,944,000)	4320
4. Balance, end of period (From item 3520)	$ 143,983,000	4330

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FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of December 31, 1984

FINANCIAL AND OPERATIONAL DATA

		Valuation		Number	
1.	Month end total number of stock record breaks unresolved over three business days				
	A. breaks long	$ -0-	4890	-0-	4900
	B. breaks short	$ -0-	4910	-0-	4920

2. Is the firm in compliance with Rule 17a-13 regarding periodic count and verification of securities positions and locations at least once in each calendar quarter? (Check one) Yes ☒ [4930] No ☐ [4940]

A. If response is negative attach explanation of steps being taken to comply with Rule 17a-13.

3.	Personnel employed at end of reporting period:		
	A. Income producing personnel	6,955	4950
	B. Non-income producing personnel (all other)	8,810	4960
	C. Total	15,765	4970
4.	Actual number of tickets executed during current month of reporting period	851,788	4980
5.	Number of corrected customer confirmations mailed after settlement date	7,086	4990

		No. of Items		Debit (Short Value)		No. of Items		Credit (Long Value)	
6.	Money differences		5000	$	5010		5020	$	5030
7.	Security suspense accounts		5040	$	5050		5060	$	5070
8.	Security difference accounts		5080	$	5090		5100	$	5110
9.	Commodity suspense accounts		5120	$	5130		5140	$	5150
10.	Open transactions with correspondents, other brokers, clearing organizations, depositories and interoffice and intercompany accounts which could result in a charge-unresolved amounts over 30 calendar days		5160	$	5170		5180	$	5190
11.	Bank account reconciliations-unresolved amounts over 30 calendar days		5200	$	5210		5220	$	5230
12.	Open transfers over 40 calendar days, not confirmed		5240	$	5250		5260	$	5270
13.	Transactions in reorganization accounts-over 60 calendar days		5280	$	5290		5300	$	5310
14.	Total		5320	$	5330		5340	$	5350

		No. of Items		Ledger Amount		Market Value	
15.	Failed to deliver 11 business days or longer (21 business day or longer in the case of Municipal Securities)		5360	$	5361	$	5362
16.	Failed to receive 11 business days or longer (21 business day or longer in this case of Municipal Securities)		5363	$	5364	$	5365

17.	Security concentrations (See instructions in Part I)		
	A. Proprietary positions	$ -0-	5370
	B. Customers' accounts under Rule 15c3-3	$ -0-	5374
18.	Total of personal capital borrowings due within six months	$ -0-	5378
19.	Maximum haircuts on underwriting commitments during the period	$ 12,128,000	5380
20.	Planned capital expenditures for business expansion during next six months	$ 7,011,000	5382
21.	Liabilities of other individuals or organizations guaranteed by respondent	$ -0-	5384
22.	Lease and rentals payable within one year	$ 48,503,000	5386
23.	Aggregate lease and rental commitments payable for entire term of the lease		
	A. Gross	$164,503,000	5388
	B. Net	$159,898,000	5390

OMIT PENNIES

Note: See Financial and Operational Data, page 2, for Item 1 and Items 6 through 16.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of 12/31/84

FINANCIAL AND OPERATIONAL DATA
Operational Deductions From Capital (Note A)

	I No. of Items		II Debits (Short Value)		III Credits (Long Value)		IV Deductions in Computing Net Capital	
1. Money suspense and balancing differences	-0-	[illegible]	$ -0-	[illegible]	$ -0-	[illegible]	$ -0-	[illegible]
2. Security suspense and differences with related money balances L	164	[illegible]	-0-	[illegible]	21,067	[illegible]	1,627,000	[illegible]
S	4	[illegible]	5	[illegible]	-0-	[illegible]	-0-	[illegible]
3. Market value of short and long security suspense and differences without related money (other than reported in line 4., below)	111	[illegible]	3,793	[illegible]	-0-	[illegible]	1,598,000	[illegible]
4. Market value of security record breaks	-0-	[illegible]	-0-	[illegible]	-0-	[illegible]	-0-	[illegible]
5. Unresolved reconciling differences with others: A. Correspondents and Broker/Dealers L	-0-	[illegible]	-0-	[illegible]	-0-	[illegible]	-0-	[illegible]
S	-0-	[illegible]	-0-	[illegible]	-0-	[illegible]	-0-	[illegible]
B. Depositories	-0-	[illegible]	-0-	[illegible]	-0-	[illegible]	-0-	[illegible]
C. Clearing Organizations L	-0-	5670	-0-	5870	-0-	6070	-0-	[illegible]
S	-0-	5675	-0-	5875	-0-	6075	-0-	[illegible]
D. Inter-company Accounts	-0-	[illegible]	-0-	[illegible]	-0-	[illegible]	-0-	[illegible]
E. Bank Accounts and Loans	36	[illegible]	240	[illegible]	616	[illegible]	83,000	[illegible]
F. Other	-0-	5700	-0-	[illegible]	-0-	[illegible]	-0-	[illegible]
G. (Offsetting) Items A. through F.	(30)	5720	(157)	[illegible]	(157)	[illegible]	▨	▨
TOTAL Line 5.	6	5730	83	[illegible]	459	[illegible]	83,000	[illegible]
6. Commodity Differences	-0-	5740	-0-	[illegible]	-0-	[illegible]	-0-	[illegible]
7. Open transfers and reorganization account items over 40 days not confirmed or verified	593	5760	4,243	[illegible]	-0-	[illegible]	-0-	[illegible]
8. TOTAL (Lines 1.-7.)	878	5770	$ 8,124	[illegible]	$ 21,526	[illegible]	$3,308,000	[illegible]
9. Lines 1.-6. resolved subsequent to report date		5775	$	[illegible]	$	[illegible]	$	6177
10. Aged Fails—to deliver	684	5780	$ 25,275	[illegible]	$ 25,148	[illegible]	$3,249,000	6182
—to receive	300	5785	$ 20,205	[illegible]	$ 20,537	[illegible]	$1,047,000	6187
			(Omit 000's)		(Omit 000's)		(Omit Pennies)	

NOTE A—This section must be completed as follows:

1. All member organizations must complete column IV, lines 1. through 8. and 10., reporting deductions from capital as of the report date whether resolved subsequently or not (see instructions relative to each line item).
2. a. Columns I, II and III of lines 1. through 8. and 10. must be completed when a Part II filing is required.
   b. Columns I, II and III of lines 1. through 8. must be completed with a Part I filing, only if the total deduction on line 8. column IV equals or exceeds 25% of excess net capital as of the prior month end reporting date. All columns of line 10. require completion.
3. A response to line 9., cols. I through IV and the "Potential Operational Charges Not Deducted From Capital" schedule on p. 3 are required only if:
   a. The parameters cited in 2.b. above exist; and
   b. The total deduction, line 8. column IV, for the current month exceeds the total deductions for the prior month by 50% or more.
4. All columns and line items (1. through 10.) must be answered if required. If respondent has nothing to report enter -0-.

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Other Operational Data (Items 1., 2. and 3. below require an answer)

Item 1. Have the accounts enumerated on lines 5.A. through F. above been reconciled with statements received from others within 35 days for lines 5.A through D. and 65 days for lines 5.E. and F. prior to the report date and have all reconciling differences been appropriately comprehended in the computation of net capital at the report date? If this has not been done in all respects, answer No.

Yes X [illegible]
No ___ [illegible]

Item 2. Do the respondent's books reflect a concentrated position (See Instruction) in commodities? If Yes report the totals (000 omitted) in accordance with the specific instructions; if No answer -0- for:

A. Firm Trading and Investment Accounts A. -0- [illegible]
B. Customers' and Non-Customers' and Other Accounts B. -0- [illegible]

Item 3. Does respondent have any planned operational or organizational changes? (Answer Yes or No based on specific instructions.)

Yes ___ [illegible]
No X [illegible]

EF Hutton & Company Inc.
Member New York Stock Exchange

EFHutton

One State Street Plaza
New York, New York 10004
Telephone (212) 742-5000

SUBORDINATED LIABILITIES

December 31, 1984

First Interstate Bank* - Due 1985-1986	$ 6,000,000.00
Royal Bank of Canada - Due 1985	11,000,000.00
Subordinated Deferred Compensation	126,983,000.00
Total Subordinated Liabilities (FOCUS Item 1710)	$ 143,983,000.00

* Formerly United California Bank

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

ANNUAL AUDITED REPORT
FORM X-17A-5
PART III

FACING PAGE

Information Required of Brokers and Dealers
Pursuant to Section 17 of the Securities
Exchange Act of 1934 and Rule 17a-5 Thereunder

SEC FILE NO.
8- 9202

REPORT FOR THE PERIOD BEGINNING 1/1/84 (MM/DD/YY) AND ENDING 12/31/84 (MM/DD/YY)

Filed as Confidential Information with the SEC

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

E.F. Hutton & Company Inc.

Official Use Only
FIRM ID. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS:
(Do not use P.O. Box No.)

One Battery Park Plaza
(No. and Street)

New York, (City) New York (State) 10004 (Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Michael P. Castellano (212) 742-3546
(Area Code — Telephone No.)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*
(Name - - if individual, state last, first, middle name)

Arthur Andersen & Co.

(ADDRESS) 1345 Avenue of the Americas, (Number and Street) New York, (City) New York (State) 10105 (Zip Code)

CHECK ONE:

☒ Certified Public Accountant
☐ Public Accountant
☐ Accountant not resident in United States or any of its possessions.

FOR OFFICIAL USE ONLY

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* *Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption.*
See section 240.17a-5(e)(2).

EF Hutton & Company Inc.
Member New York Stock Exchange

EFHutton

One Battery Park Plaza
New York, NY 10004
Telephone: (212) 742-5000

February 15, 1985

CONTENTS OF REPORT

This report ** contains (check all applicable boxes)

- ☒ (a) Facing page
- ☒ (b) Statement of Financial Condition
- ☒ (c) Statement of Income (loss)
- ☒ (d) Statement of Changes in Financial Condition
- ☒ (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietor's Capital.
- ☒ (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors
- ☒ (g) Computation of Net Capital
- ☒ (h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
- ☒ (i) Information Relating to the Possession or Control Requirements Under Rule 15c3-3.
- ☒ (j) A Reconciliation, including appropriate explanation, of ~~the Computation of Net Capital Under Rule 15c3-1 and~~ the Computation for Determination of the Reserve Requirements Under Exhibit A of Rule 15c3-3.
- ☒ (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation. (See Note 2 to Consolidated Financial Statements)
- ☒ (l) An Oath or Affirmation
- ☐ (m) A copy of the SIPC Supplemental Report
- ☐ (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.
- ☒ (o) Schedule of Segregation Requirements and Funds in Segregation

** *For conditions of confidential treatment of certain portions of this filing, see section 240.17a-5(e)(3).*

EF Hutton & Company Inc.
Member New York Stock Exchange

EFHutton

One Battery Park Plaza
New York, NY 10004
Telephone: (212) 742-5000

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

February 15, 1985

We, the undersigned, officers and directors of E. F. Hutton & Company Inc., hereby affirm that, to the best of our knowledge and belief, the attached consolidated financial statements and supplementary schedules as of December 31, 1984, are true and correct, and that neither the Company nor any officer or director has any proprietary interest in any account classified solely as that of a customer except as indicated in Note (3) to the consolidated financial statements.

In addition, as allied members of the New York Stock Exchange, Inc., we do hereby certify that the attached consolidated financial statements and supplementary schedules as of December 31, 1984, will promptly be made available to those E. F. Hutton & Company Inc. members and allied members whose signatures do not appear below.

Robert Fomon
Robert Fomon
Chairman

Thomas P. Lynch
Executive Vice President
and Secretary

Subscribed and sworn to before me
this 15th day of February, 1985

Barbara K. Hunt
Notary Public

BARBARA K. HUNT
Notary Public, State of New York
No. [illegible]612690
Qualified in Westchester County
Commission Expires March 30, 1986

Arthur Andersen & Co.
New York, N. Y.

To E. F. Hutton & Company Inc.:

We have examined the consolidated statement of financial condition of E. F. Hutton & Company Inc. (a Delaware corporation and a wholly-owned subsidiary of The E. F. Hutton Group Inc.) and subsidiaries as of December 31, 1984, and the related consolidated statements of income, changes in stockholder's equity, changes in financial position, and changes in subordinated liabilities for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of E. F. Hutton & Company Inc. and subsidiaries as of December 31, 1984, and the results of their operations and the changes in their financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Our examination was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The information contained in schedules I, II, III and IV is presented for purposes of additional analysis, is not a required part of the basic financial statements, but is supplementary information required by Rule 17a-5 of the Securities and Exchange Commission. Such information has been subjected to the auditing procedures applied in the examination of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Arthur Andersen & Co.

February 15, 1985

E. F. HUTTON & COMPANY INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF FINANCIAL CONDITION

AS OF DECEMBER 31, 1984

(000's omitted)

ASSETS

Cash subject to immediate withdrawal	$ 36,249
Amounts segregated under Federal commodity and other regulations:	
Cash	118,758
Securities, at market value	22,116
Securities purchased under agreements to resell	6,778,196
Securities, at market value:	
U. S. Government	1,281,695
Certificates of deposit	768,453
State and municipal	1,147,979
Corporate	1,091,819
Receivable from clients, less reserve of $30,616 (Note 3)	2,277,460
Receivable from brokers and dealers	1,515,870
Office equipment and leasehold improvements, at cost, less accumulated depreciation and amortization of $91,265	154,250
Dividends and interest receivable	85,320
Other assets	177,006
	$15,455,171

LIABILITIES AND STOCKHOLDER'S EQUITY

Liabilities:	
Bank loans (Note 4)	$ 831,842
Drafts and checks payable	405,344
Securities sold under agreements to repurchase	7,745,847
Securities sold but not yet purchased, at market value:	
U. S. Government	1,706,708
State and municipal	85,804
Corporate	513,264
Payable to clients (Note 3)	1,461,755
Payable to brokers and dealers	907,631
Accrued compensation	136,614
Dividends and interest payable	85,789
Income taxes payable (Note 9)	25,705
Payable to parent (Note 11)	762,538
Other liabilities	173,543
	14,842,384
Subordinated liabilities (Note 5)	149,353
Total liabilities	14,991,737
Commitments and contingent liabilities (Notes 8 and 10)	
Stockholder's equity (Notes 5 and 6):	
Capital stock and additional paid-in capital	95,916
Retained earnings	367,968
Cumulative translation adjustment	(450)
Total stockholder's equity	463,434
	$15,455,171

The accompanying notes are an integral part of this statement.

E. F. HUTTON & COMPANY INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INCOME

FOR THE YEAR ENDED DECEMBER 31, 1984

(000's omitted)

REVENUES:	
Commissions	$ 544,602
Interest	864,292
Investment banking	267,435
Principal transactions	194,196
Insurance	58,272
Other	115,151
	2,043,948
EXPENSES:	
Employee compensation and benefits	801,529
Interest	674,228
Communications	113,947
Occupancy and equipment	118,923
Advertising and sales promotion	48,738
Brokerage, clearing and exchange fees	39,863
Professional fees	26,957
Other	144,706
	1,968,891
Income before taxes	75,057
INCOME TAX EXPENSE (Note 9.)	28,228
Net income	$ 46,829

The accompanying notes are an integral part of this statement.

E. F. HUTTON & COMPANY INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDER'S EQUITY

FOR THE YEAR ENDED DECEMBER 31, 1984

(000's omitted)

	Capital Stock ($10 Par Value)	Additional Paid-in Capital	Retained Earnings	Cumulative Translation Adjustment	Total
BALANCE, December 31, 1983	$2	$25,914	$346,139	$(182)	$371,873
Net income	-	-	46,829	-	46,829
Dividends paid to parent	-	-	(25,000)	-	(25,000)
Capital contribution from parent	-	70,000	-	-	70,000
Translation adjustment	-	-	-	(268)	(268)
BALANCE, December 31, 1984	$2	$95,914	$367,968	$(450)	$463,434

The accompanying notes are an integral part of this statement.

E. F. HUTTON & COMPANY INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED DECEMBER 31, 1984

(000's omitted)

FUNDS PROVIDED:	
Net income	$ 46,829
Add expenses not requiring the outlay of funds-	
Depreciation and amortization	27,471
Deferred tax provision, net	5,519
Funds provided by operations	79,819
Capital contribution by parent	70,000
Increase in net agreements to repurchase or resell	944,384
Increase in bank loans	285,402
Decrease in net receivable from clients	76,492
Increase in subordinated liabilities, net	22,443
Total funds provided	$1,478,540
FUNDS APPLIED:	
Payment of cash dividends	$ 25,000
Increase in net securities, at market value	618,041
Increase in net receivable from brokers and dealers	590,332
Additions to office equipment and leasehold improvements, net	76,090
Decrease in income taxes payable	47,689
Decrease in drafts and checks payable	30,625
Decrease in accrued compensation	14,070
Decrease in net dividends and interest payable	47,320
Increase in cash subject to immediate withdrawal	9,235
Decrease in payable to parent	6,753
Increase in amounts segregated under Federal commodity and other regulations	5,873
Other changes, net	7,512
Total funds applied	$1,478,540

The accompanying notes are an integral part of this statement.

E. F. HUTTON & COMPANY INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN SUBORDINATED LIABILITIES

FOR THE YEAR ENDED DECEMBER 31, 1984

(000's omitted)

	December 31, 1983	Additions	Reductions	December 31, 1984
Senior subordinated notes payable to banks:				
Due 1984-1986	$ 10,000	$ -	$ 4,000	$ 6,000
Due 1985	11,000	-	-	11,000
Subordinated deferred compensation	105,910	47,243	20,800	132,353
Total	$126,910	$ 47,243	$ 24,800	$149,353

The accompanying notes are an integral part of this statement.

E. F. HUTTON & COMPANY INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1984

(1) Summary of accounting policies:

The consolidated financial statements include the accounts of E. F. Hutton & Company Inc. and all wholly-owned subsidiaries (the "Company"). Intercompany balances and transactions have been eliminated. The Company is a wholly-owned subsidiary of The E. F. Hutton Group Inc. (the "Parent").

Securities, commodities and open future and forward contracts are valued at market and the resulting unrealized gains and losses are reflected in income. Securities and commodities principal transactions, excluding delayed delivery contractual commitments, are generally recorded on trade date; securities commission income and related expenses are recorded on settlement date. Commodities commission income and related expenses are recorded on trade date.

Securities purchased under agreements to resell and securities sold under agreements to repurchase are collateralized financing transactions and are carried at the amounts at which the securities will be subsequently resold or repurchased plus accrued interest.

Office equipment is depreciated under the double-declining balance method over its estimated useful life, generally ten years. Leasehold improvements are amortized over the terms of the related agreements.

(2) Reconciliation of assets, liabilities and stockholder's equity

These financial statements have been prepared on the basis of generally accepted accounting principles and differ in certain respects from the accounting prescribed by the Securities and Exchange Commission's general instructions to Form X-17A-5. Under the Securities and Exchange Commission's general instructions, certain subsidiaries may not be consolidated. Part II of Form X-17A-5 filed by the Company on January 24, 1985, was prepared in accordance with the instructions and therefore certain subsidiaries were not consolidated.

A reconciliation of the amounts reported herein to amounts reported by the Company on Part II of Form X-17A-5 filed with the Securities and Exchange Commission for the period ended December 31, 1984, is as follows (000's omitted):

	Part II of Form X-17A-5	Reclassifications	Additional Subsidiaries Consolidated	Financial Statements
Assets:				
Cash subject to immediate withdrawal	$ 30,513	$ 692	$ 5,044	$ 36,249
Amounts segregated under Federal commodity and other regulations	99,823	41,051	-	140,874
Securities purchased under agreements to resell	6,646,671	(6,163)	137,688	6,778,196
Securities, at market value	3,942,068	(21,900)	369,778	4,289,946
Receivable from clients	2,165,546	16,661	95,253	2,277,460
Receivable from brokers and dealers	1,502,231	9,153	4,486	1,515,870
Exchange memberships, at cost	4,950	(5,321)	371	-
Office equipment and leasehold improvements, at cost, net	152,499	-	1,751	154,250
Dividends and interest receivable	12,333	64,132	8,855	85,320
Other assets	251,889	(76,831)	1,948	177,006
	$14,808,523	$ 21,474	$ 625,174	$15,455,171
Liabilities:				
Bank loans	$ 1,158,213	$(402,587)	$ 76,216	$ 831,842
Drafts and checks payable	775	402,587	1,982	405,344
Securities sold under agreements to repurchase	7,545,041	26,726	174,080	7,745,847
Securities sold but not yet purchased, at market value	2,296,080	-	9,696	2,305,776
Payable to clients	1,345,815	1,847	114,093	1,461,755
Payable to brokers and dealers	843,994	15,380	48,257	907,631
Accrued compensation	136,671	(57)	-	136,614
Dividends and interest payable	85,774	15	-	85,789
Income taxes payable	24,508	(116)	1,313	25,705
Payable to parent	571,711	(1,973)	192,800	762,538
Other liabilities	187,154	(15,707)	2,096	173,543
Subordinated liabilities	149,353	-	-	149,353
	14,345,089	26,115	620,533	14,991,737
Stockholder's equity	463,434	(4,641)	4,641	463,434
	$14,808,523	$ 21,474	$ 625,174	$15,455,171

Consolidated in Part II of Form X-17A-5 is a guaranteed subsidiary which is not a registered broker/dealer and whose deficit in stockholder's equity is $669,000.

(3) Receivable from and payable to clients:

The amounts represent balances arising from normal cash and margin transactions. Receivable from clients is collateralized by securities and commodities held by the Company.

Accounts of officers, directors and employees are included in receivable from and payable to clients since they are subject to the same terms and regulations and, in the aggregate, are not significant.

(4) Bank loans:

Bank loans consist of secured and unsecured short-term borrowings of $251,342,000 and $580,500,000, respectively. The weighted average interest rate during 1984, based on the average loan balance outstanding during the year of $307,824,000 was 10.26% and the highest month-end loan balance in 1984 was $831,842,000. At December 31, 1984, the weighted average interest rate was 9.24%.

(5) Subordinated liabilities:

These liabilities are subordinated to the claims of general creditors of the Company, and are thus generally included by the Company in computing "net capital" under the Securities and Exchange Commission's net capital rule.

Interest on the senior subordinated notes is payable periodically at rates based on the London interbank offered rate or the prime rate. Interest rates in effect at December 31, 1984 for the $11,000,000 and $6,000,000 senior subordinated notes were 10.50% and 12.56%, respectively. The note agreements contain certain restrictions with respect to minimum "net capital" and "net worth" requirements and may limit the payment of dividends and additional borrowings.

Subordinated deferred compensation is payable in annual installments beginning generally upon the retirement of each participant or upon specified dates through 2009. Subordinated deferred compensation consists of the following (000's omitted):

Partnership Award Plan	$ 44,744
Regular deferred compensation	87,609
	$132,353

Partnership Award Plan balances are credited or charged with interest at a rate which equals the after-tax rate of profit or loss on the consolidated common equity of The E. F. Hutton Group Inc. and its subsidiaries. In 1984 interest on regular deferred compensation accrued at one-half of the prime rate plus 1%, compounded monthly; in 1985 it will accrue at the 90-day U.S. Treasury Bill rate.

(6) Net capital requirements:

The Company is subject to the net capital rule of the Securities and Exchange Commission. Under the alternative method permitted by the rule, the required net capital shall not be less than two percent of aggregate debit items arising from client transactions, as defined. The New York Stock Exchange, Inc. may also require a member organization to reduce its business if its net capital is less than four percent of aggregate debit items and may prohibit a member from expanding its business and declaring cash dividends if its net capital is less than five percent of aggregate debit items. At December 31, 1984, net capital of $166,351,000 was 8.29% of aggregate debit items, and net capital in excess of the minimum required was $126,208,000.

(7) Retirement plans:

The Company has a noncontributory retirement plan covering substantially all employees. Total pension expense for 1984 was $3,667,000. The Company's policy is to fund accrued pension costs when such costs are deductible for income tax purposes. The assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 12% for those receiving benefits as of January 1, 1982 and 9.5% for all others.

A comparison of accumulated vested and nonvested benefits with plan assets available for distribution as of January 1, 1984, the date of the latest actuarial valuation, are as follows (000's omitted):

Actuarial present value of accumulated plan benefits:	
Vested	$25,433
Nonvested	6,346
Total present value	$31,779
Plan assets available for distribution	$61,524

In addition to providing pension benefits, the Company provides for certain health care and life insurance benefits for substantially all retired employees. The cost of retiree health care and life insurance in 1984 was not significant.

(8) Commitments:

The Company leases office space and communications equipment under noncancelable lease agreements which expire on various dates through 2008, and also leases certain computer equipment under agreements expiring on various dates through 1988. The occupancy lease agreements, in addition to base rentals, generally provide for rent escalations resulting from increased assessments for real estate taxes and other charges. The Company has no significant leases requiring capitalization.

Rent expense for the year ended December 31, 1984, was $79,688,000.

Minimum rentals for each of the next five years and for the subsequent period are as follows (000's omitted):

Year	Minimum Rentals
1985	$ 67,281
1986	64,122
1987	60,460
1988	43,807
1989	35,128
1990-2008	413,247

In the normal course of business, the Company enters into underwriting and delayed delivery commitments, including the purchase and sale of forward contracts involving mortgage-backed securities and foreign currencies. In management's opinion, these commitments will settle without a material effect on the financial position of the Company.

(9) Income taxes:

The Company is included in the consolidated federal income tax return of the Parent; the Company's income taxes are computed on a separate company basis.

Income taxes are provided on items of income and expense that are recognized in different periods for accounting and tax purposes. The amounts of current and deferred income tax expense for the year ended December 31, 1984, are as follows (000's omitted):

Current tax:	
Federal	$12,539
State and local	8,738
Foreign	1,432
Deferred tax expense, net	5,519
	$28,228

The net deferred tax expense is related to deferred compensation expense, accruals not currently deductible, prepaid compensation, depreciation and other expenses.

The following is a reconciliation of the provision for income taxes and the amount computed by applying the Federal statutory rate (46%) to income before taxes (000's omitted):

Tax computed at statutory rate	$34,526
State and local taxes, net of Federal income tax benefit	5,352
Tax effect of:	
Municipal bond interest	(4,937)
Corporate dividends received deduction	(5,557)
Investment tax credits	(3,671)
Other, net	2,515
	$28,228

The Federal income tax returns of the Parent for 1974 through 1983 are currently under examination.

(10) Contingent liabilities:

The Company is a defendant in legal actions relating to its securities, commodities, insurance and investment banking activities. Certain of these actions purport to be brought on behalf of various classes of claimants and seek damages of material or indeterminate amounts. Included in these actions is a consolidated class action relating to the Company's sale of single premium deferred annuities of Baldwin-United subsidiaries. Pursuant to a tentative settlement agreement in the above cited class action, the Company has provided a reserve of $34,000,000. In the opinion of management, the actions will not result in any material adverse effect on the financial position of the Company.

The Company was contingently liable as of December 31, 1984, in the amount of $290,563,000 under letter of credit agreements used primarily in lieu of margin deposits with certain options and commodities clearing organizations. These agreements are generally made for periods of one to six months and bear interest at 1/4% to 1/2%.

(11) Related party transactions:

In the ordinary course of business, the Company enters into transactions with its Parent and affiliates which include noninterest-bearing advances from the Parent and the sale of an affiliate's life insurance products.

SCHEDULE I
Page 1

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of December 31, 1984

COMPUTATION OF NET CAPITAL (Dollar amounts in thousands)

1. Total ownership equity (from Statement of Financial Condition – Item 1800) *					$ 463,434	3480
2. Deduct: Ownership equity not allowable for net capital					(–)	3490
3. Total ownership equity qualified for net capital					463,434	3500
4. Add:						
A. Liabilities subordinated to claims of general creditors allowable in computation of net capital					143,983	3520
B. Other (deductions) or allowable credits (List)					$ –	3525
5. Total capital and allowable subordinated liabilities					$ 607,417	3530
6. Deductions and/or charges:						
A. Total non-allowable assets from Statement of Financial Condition (Notes B and C)			$ 322,858	3540		
1. Additional charges for customers' and non-customers' security accounts			8,483	3550		
2. Additional charges for customers' and non-customers' commodity accounts			5,815	3560		
B. Aged fail-to-deliver:			3,249	3570		
1. Number of items	$ 684	3450				
C. Aged short security differences-less reserve of	$ –	3460	$ 1,598	3580		
number of items	111	3470				
D. Secured demand note deficiency			–	3590		
E. Commodity futures contracts and spot commodities – proprietary capital charges			2	3600		
F. Other deductions and/or charges			4,786	3610		
G. Deductions for accounts carried under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x)			–	3615		
H. Total deductions and/or charges					(346,791)	3620
7. Other additions and/or allowable credits (List)					–	3630
8. Net Capital before haircuts on securities positions					$ 260,626	3640
9. Haircuts on securities: (computed, where applicable, pursuant to 15c3-1 (f)):						
A. Contractual securities commitments			2,466	3660		
B. Subordinated securities borrowings			–	3670		
C. Trading and investment securities:						
1. Bankers' acceptances, certificates of deposit and commercial paper			$ 2,387	3680		
2. U.S. and Canadian government obligations			13,548	3690		
3. State and municipal government obligations			24,562	3700		
4. Corporate obligations			29,697	3710		
5. Stocks and warrants			13,143	3720		
6. Options			6,155	3730		
7. Arbitrage			–	3732		
8. Other securities			$ 2,039	3734		
D. Undue concentration			225	3650		
E. Other (list) *			53	3736	(94,275)	3740
10. Net Capital					$ 166,351	3750

OMIT PENNIES

* Long Market value of partly secured customer accounts.

SCHEDULE I
Page 2

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of December 31, 1984

COMPUTATION OF BASIC NET CAPITAL REQUIREMENT (Dollar amounts in thousands)

Part A

11. Minimum net capital required (6-2/3% of line 19) $ N/A [3756]
12. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A) $ N/A [3758]
13. Net capital requirement (greater of line 11 or 12) $ N/A [3760]
14. Excess net capital (line 10 less 13) $ N/A [3770]
15. Excess net capital at 1000% (line 10 less 10% of line 19) $ N/A [3780]

COMPUTATION OF AGGREGATE INDEBTEDNESS

16. Total A.I. liabilities from Statement of Financial Condition $ N/A [3790]
17. Add:
    - A. Drafts for immediate credit $ ______ [3800]
    - B. Market value of securities borrowed for which no equivalent value is paid or credited $ ______ [3810]
    - C. Other unrecorded amounts (List) $ ______ [3820] $ N/A [3830]
18. Deduct: Adjustment based on deposits in Special Reserve Bank Accounts (15c3-1 (c) (1) (vii)) $ N/A [3838]
19. Total aggregate indebtedness $ N/A [3840]
20. Percentage of aggregate indebtedness to net capital (line 19 ÷ by line 10) % N/A [3850]
21. Percentage of Aggregate Indebtedness to net capital *after* anticipated capital withdrawals (line 19 ÷ by line 10 less Item 4880 page 11) % N/A [3853]

COMPUTATION OF ALTERNATE NET CAPITAL REQUIREMENT

Part B

22. 2% of combined aggregate debit items as shown in Formula for Reserve Requirements pursuant to Rule 15c3-3 prepared as of the date of the net capital computation including both brokers or dealers and consolidated subsidiaries' debits $ 40,118 [3870]
23. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A) $ 40,143 [3880]
24. Net capital requirement (greater of line 22 or 23) $ 40,143 [3760]
25. Excess net capital (line 10 less 24) $ 126,208 [3910]
26. Percentage of Net Capital to Aggregate Debits (line 10 ÷ by line 17 page 8) % 8.29 [3851]
27. Percentage of Net Capital, *after* anticipated capital withdrawals, to Aggregate Debits (line 10 less Item 4880 page 11 ÷ by line 17 page 8) % ______ [3854]
28. Net capital in excess of the greater of:
    - A. 4% of combined aggregate debit items or $120,000 $ 86,064 [3920]
    - B. 5% of combined aggregate debit items or $120,000 $ 65,993 [3930]

OTHER RATIOS

Part C

29. Percentage of debt to debt-equity total computed in accordance with Rule 15c3-1 (d) % ______ [3860]
30. Options deductions/Net Capital ratio (1000% test) total deductions exclusive of liquidating equity under Rule 15c3-1(a)(6), (a)(7) and (c)(2)(x) ÷ Net Capital % ______ [3852]

NOTES:

(A) The minimum net capital requirement should be computed by adding the minimum dollar net capital requirement of the reporting broker dealer and, for each subsidiary to be consolidated, the greater of:
1. Minimum dollar net capital requirement, or
2. 6-2/3% of aggregate indebtedness or 4% of aggregate debits if alternative method is used.

(B) Do not deduct the value of securities borrowed under subordination agreements or secured demand notes covered by subordination agreements not in satisfactory form and the market values of memberships in exchanges contributed for use of company (contra to item 1740) and partners' securities which were included in non-allowable assets.

(C) For reports filed pursuant to paragraph (d) of Rule 17a-5, respondent should provide a list of material non-allowable assets. (see Schedule I, page 3).

SCHEDULE I
Page 3

E. F. HUTTON & COMPANY INC.

SCHEDULE OF NONALLOWABLE ASSETS

DECEMBER 31, 1984

(000's omitted)

	Amount
Office equipment and leasehold improvements, net	$152,499
Deferred taxes receivable	52,795
Employee loans and advances	34,583
Deferred compensation expense	31,955
Receivable from clients	7,669
Exchange memberships, at cost	4,950
Other	38,407
	$322,858

The accompanying notes to supplementary schedules are an integral part of this schedule.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT PART II

SCHEDULE II
Page 1

BROKER OR DEALER E. F. Hutton & Company Inc.   **as of** December 31, 1984

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS FOR BROKER-DEALERS UNDER RULE 15c3-3

(See Rule 15c3-3, Exhibit A and Related Notes)

(Dollar amounts in thousands)

CREDIT BALANCES				
1. Free credit balances and other credit balances in customers' security accounts (see Note A, Exhibit A, Rule 15c3-3)	$1,111,016	4340		
2. Monies borrowed collateralized by securities carried for the accounts of customers (see Note B)	89,500	4350		
3. Monies payable against customers' securities loaned (see Note C)	325,109	4360		
4. Customers' securities failed to receive (see Note D)	92,027	4370		
5. Credit balances in firm accounts which are attributable to principal sales to customers	346,720	4380		
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days	49	4390		
7. **Market value of short security count differences over 30 calendar days old	72	4400		
8. **Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days	3,721	4410		
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days	4,243	4420		
10. Other (List)	–	4425		
11. TOTAL CREDITS			$ 1,972,457	4430
DEBIT BALANCES				
12. **Debit balances in customers' cash and margin accounts excluding unsecured accounts and accounts doubtful of collection net of deductions pursuant to Note E, Exhibit A, Rule 15c3-3	$ 1,793,407	4440		
13. Securities borrowed to effectuate short sales by customers and securities borrowed to make delivery on customers' securities failed to deliver	121,567	4450		
14. Failed to deliver of customers' securities not older than 30 calendar days	90,943	4460		
15. Margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in customer accounts (See Note F)	–	4465		
16. Other (List)	–	4469		
17. **Aggregate debit items			$ 2,005,917	4470
18. **less 3% (for alternative method only — see Rule 15c3-1 (f) (5) (i))			(60,178)	4471
19. **TOTAL 15c3-3 DEBITS			$1,945,739	4472
RESERVE COMPUTATION				
20. Excess of total debits over total credits (line 19 less line 11)			$ –	4480
21. Excess of total credits over total debits (line 11 less line 19)			26,718	4490
22. If computation permitted on a monthly basis, enter 105% of excess of total credits over total debits			–	4500
23. Amount held on deposit in "Reserve Bank Account(s)", including value of qualified securities, at end of reporting period			–	4510
24. Amount of deposit (or withdrawal) including $ ______ 4515 value of qualified securities			30,000	4520
25. New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including $ ______ 4525 value of qualified securities			$ –	4530
26. Date of deposit (MMDDYY)			01-03-85	4540
			OMIT PENNIES	

The accompanying notes to supplementary schedules are an integral part of this schedule.

FREQUENCY OF COMPUTATION

27. Daily ______ 4332 Weekly ______ 4333 Monthly ______ 4334

**In the event the Net Capital Requirement is computed under the alternative method, this "Reserve Formula" shall be prepared in accordance with the requirements of paragraph (f) of Rule 15c3-1.

SCHEDULE II
Page 2

E. F. HUTTON & COMPANY INC.

RECONCILIATION OF THE COMPUTATION FOR DETERMINATION OF THE RESERVE REQUIREMENTS OF RULE 15c3-3 PURSUANT TO RULE 17a-5(d)(4)

DECEMBER 31, 1984
(000's omitted)

Computation Line Reference	Description	Total Credits	Excess (Required Deposit)
	Company's computation	$ 1,840,813	$ 104,926
1	Reduction in allocation of proprietary and noncustomer long positions	49,497	(49,497)
3	Correction of stock loan balances allocated to customers	82,147	(82,147)
	Amounts as reported on Page 1 of Schedule II	$ 1,972,457	$ (26,718)

SCHEDULE III

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT
PART II

BROKER OR DEALER E. F. Hutton & Company Inc. as of December 31, 1984

COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS
FOR BROKER-DEALERS UNDER RULE 15c3-3 (continued)

(Dollar amounts in thousands)

EXEMPTIVE PROVISIONS

28. If an exemption from Rule 15c3-3 is claimed, identify below the section upon which such exemption is based (check one only)

A. (k) (1)—$2,500 capital category as per Rule 15c3-1	N/A	4550
B. (k) (2)(A)—"Special Account for the Exclusive Benefit of customers" maintained	N/A	4560
C. (k) (2)(B)—All customer transactions cleared through another broker-dealer on a fully disclosed basis. Name of clearing firm [4335]	N/A	4570
D. (k) (3)—Exempted by order of the Commission	N/A	4580

Information for Possession or Control Requirements Under Rule 15c3-3

State the market valuation and the number of items of:

1. Customers' fully paid securities and excess margin securities not in the respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frames specified under Rule 15c3-3. Notes A and B (Note 2)	$ 2,688	4586
A. Number of items	42	4587
2. Customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of the report date, excluding items arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3. Notes B, C and D	$ 282	4588
A. Number of items (Note 3)		4589

OMIT PENNIES

3. The system and procedures utilized in complying with the requirement to maintain physical possession or control of customers' fully paid and excess margin securities have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 15c3-3 Yes ______ [4584] No ______ [4585]

NOTES

A—Do not include in item one customers' fully paid and excess margin securities required by Rule 15c 3-3 to be in possession or control but for which no action was required by the respondent as of the report date or required action was taken by respondent within the time frames specified under Rule 15c3-3.

B—State separately in response to items one and two whether the securities reported in response thereto were subsequently reduced to possession or control by the respondent.

C—Be sure to include in item two only items not arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3.

D—Item two must be responded to only with report which is filed as of the date selected for the broker's or dealer's annual audit of financial statements, whether or not such date is the end of a calendar quarter. The response to item two should be filed within 60 calendar days after such date, rather than with the remainder of this report. This information may be required on a more frequent basis by the Commission or the designated examining authority in accordance with Rule 17a-5(a)(2)(iv).

The accompanying notes to supplementary schedules
are an integral part of this schedule.

FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT PART II

SCHEDULE IV

BROKER OR DEALER E. F. Hutton & Company Inc. as of December 31, 1984

SCHEDULE OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION

CUSTOMERS' REGULATED COMMODITY FUTURES ACCOUNTS

(Dollar amounts in thousands)

SEGREGATION REQUIREMENTS		
1. Net ledger balance		
a. Cash	$ 121,102	7010
b. Securities (at market)	187,805	7020
2. Net unrealized profit (loss) in open futures contracts	(28,915)	7030
3. Net equity (Deficit) (Total of 1 - plus or minus 2)	279,992	7040
4. Add: accounts liquidating to a deficit and accounts with debit balances with no open trades	17,914	7050
5. Amount required to be segregated (Total of 3 & 4)	$ 297,906	7060
FUNDS ON DEPOSIT IN SEGREGATION		
6. Deposited in segregated funds bank accounts:		
a. Cash	99,634	7070
b. Securities representing investments of customers' funds (at market)	–	7080
c. Securities held for customers in lieu of cash margins (at market)	187,805	7090
7. Margins on deposit with clearing organizations of contract markets:		
a. Cash	16,920	7100
b. Securities representing investments of customers' funds (at market)	11,344	7110
c. Securities held for customers in lieu of cash margins (at market)	–	7120
8. Settlement due from (to) contract market clearing organization	(1,745)	7130
9. Net equities with other FCMs	–	7140
10. Segregated funds on hand:		
a. Cash	–	7150
b. Securities representing investments of customers' funds (at market)	–	7160
c. Securities held for customers in lieu of cash margins (at market)	–	7170
11. Total amount in segregation (Total of 6 through 10)	$ 313,958	7180
12. Excess funds (insufficiency) in segregation (11 minus 5)	$ 16,052	7190

The accompanying notes to supplementary schedules are an integral part of this schedule.

E. F. HUTTON & COMPANY INC.

NOTES TO SUPPLEMENTARY SCHEDULES

DECEMBER 31, 1984

(1) No material differences exist between the audited Computation of Net Capital (Schedule I) or the audited Schedule of Segregation Requirements and Funds in Segregation (Schedule IV), and the corresponding schedules included in the Company's unaudited December 31, 1984 Part II FOCUS filing.

(2) The Company has subsequently reduced to possession or control the positions included in the response to Item 1 of the Information for Possession or Control Requirements (Schedule III), except for 9 items with a market value of $95,510.

(3) It is impractical to determine the number of items in response to Item 2 of the Information for Possession or Control Requirements (Schedule III). Similarly, it is impractical to determine that the Company has subsequently issued instructions to reduce to possession or control those items included therein or further to determine that such instructions were acted upon.

Mr. **Hughes**. Well, thank you very much. You've been very patient. It's almost 5 o'clock.

And we do appreciate your cooperation. We do have a couple of hundred thousand pieces of paper we would like to return to you that are not particularly pertinent, and there is a great deal of information that we requested.

I wonder if we can establish some timetable, Mr. Fomon? I realize you can't do it today, because obviously you're not conversant with what is there and I am not particularly conversant. But if we can agree that your counsel and employees will sit down with our counsel and go through the various categories and arrive at some reasonable timetable, I am thinking in terms of 3 weeks at this posture. I think we can assist you, and your counsel, and your staff at this time in identifying those areas that we are particularly interested in and make the task a little easier if we can engage in that kind of a good-faith effort.

Mr. **Fomon**. I think it's—I think we have to sit down together and cover what material it is you want. You understand that this material, as I mentioned before, is coming from 400 or 500 different locations; and I don't know if I can physically make 3 weeks.

Mr. **Hughes**. Mr. Fomon, I agree. Some of the information should have been supplied to us. You know? I really——

Mr. **Fomon**. I mean, we can get you——

Mr. **Hughes**. I really regret that we didn't have an organizational chart. We struggled for an hour, trying to do something that your organizational chart would have provided for us in 5 minutes or 10 minutes.

Mr. **Fomon**. Yes.

Mr. **Hughes**. We would have understood that management chart. Insofar as memorandums that are at headquarters, providing directives, I mean that information should have been provided directly to us.

Mr. **Fomon**. I can get that immediately.

Mr. **Hughes**. What we had was 62 cartons, most of which was not particularly relevant and which we have waded through. And we are prepared to do that, but if we can establish some timetable with your staff and with your counsel, that would facilitate the hearing.

Mr. **Fomon**. OK. Let's have a very early meeting, decide exactly what would be helpful to you. And I think if you'd give us 4 weeks to collect it, we'll get the memos to you right away. But everything that comes out of the branch offices I think I really prefer to have 4 weeks rather than 3.

Mr. **Hughes**. Insofar as employees are concerned, can we have your assurance that you will instruct the employees to come in and voluntarily submit to our questioning?

Mr. **Fomon**. Oh, absolutely.

Mr. **Hughes**. We do want to question a number of employees who have now been identified, who do have pertinent information. Many of them came out today, many that were mentioned today that we do want to question without the need to subpoena them.

Mr. **Fomon**. Absolutely. And I'm sorry that you found it necessary to subpoena me. I was looking forward to coming here. And I will see that you do not have to subpoena any employee, just let me know whom you want to call.

Mr. **Hughes**. Thank you very much.

The witnesses are still under subpoena, and we may require your testimony at some future date.

With that the subcommittee stands adjourned.

[Whereupon, at 4:53 p.m. the subcommittee was adjourned.]

E.F. HUTTON MAIL AND WIRE FRAUD CASE

FRIDAY, JULY 19, 1985

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CRIME,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to call, at 10 a.m., in room 2141, Rayburn House Office Building, Hon. William J. Hughes (chairman of the subcommittee) presiding.

Present: Representatives Hughes, Mazzoli, Morrison, Feighan, Smith, McCollum, Shaw, and Gekas.

Staff present: Hayden W. Gregory, counsel; Virginia E. Sloan, assistant counsel; Theresa Bourgeois, staff assistant; Eric E. Sterling, assistant counsel; Edward H. O'Connell, assistant counsel; Fred W. Stuckwisch, GAO consultant; Charlene Vanlier Heydinger, associate counsel; Phyllis N. Henderson, clerk; David Brog, intern.

Mr. HUGHES. The Subcommittee on Crime will come to order.

The Chair has received a request to correspond this by radio broadcast, still photography or similar methods. Permission will be granted unless there is objection. Is there objection? Hearing none, the permission will be granted.

Today is the second day of a series of hearings on the circumstances surrounding the criminal investigation of E.F. Hutton by the Department of Justice. Last May, Hutton pleaded guilty in Federal court to 2,000 counts of mail and wire fraud. The criminal activities involved abuses in Hutton's cash concentration system—chiefly, excessive drawdowns from banks all over the country, and what we refer to as "chaining" of various banks to generate float and to further create excessive drawdowns. Hutton was also enjoined from carrying out certain other activities related to its cash concentration system.

Rule X, Cl. 1, paragraph (m) of the Rules of the House of Representatives provides that the Committee on the Judiciary has Federal legislative jurisdiction over "judicial proceedings, civil and criminal generally." Clause 2 of rule X provides authority for standing committees to exercise oversight over the laws within the subject matter jurisdiction of the committee, and the organization and operation of the Federal agencies having responsibility for those laws.

Pursuant to this authority, the Subcommittee on Crime, as a part of a broader investigation of corporate crime and the disposition of such matters within the Federal criminal justice system, is conducting an in-depth analysis of the facts surrounding the recent conviction, pursuant to plea agreement, of the E.F. Hutton Co., Inc. for mail and wire fraud growing out of Hutton's cash management practices beginning in 1980. One element of that plea agreement that has drawn some public criticism is the decision of the Department to agree not to proceed against individuals responsible for the fraudulent activities, in exchange for a guilty plea by the company and its agreement to injunctive relief and restitution.

We are mindful of the fact that the Department strongly defends the propriety of the plea agreement on the grounds, among others, that, one, many of these practices were still being carried out by Hutton up until the time of the plea agreement; two, the practices were resulting in substantial losses to victim banks and could pose a threat to the banking system if they continued and became even more widespread throughout the banking and cash management communities; three, it was necessary to get the practices stopped and send a message to both those who might participate in such schemes and those who might be victimized by them that these practices are not to be tolerated; a contested trial in the Hutton case would take from several months to several years, during which time the practices would likely continue; and, four, only relatively low-level corporate officials were responsible for and involved in mail and wire fraud activities, and any public policy needs to pursue prosecution of these individuals were outweighed by other factors, set forth above.

The subcommittee is also pursuing the question of whether an atmosphere exists in corporate organizations that encourages, if not actively promotes, activities like those in which Hutton engaged.

On June 19, the subcommittee held its first hearing on this matter. It took testimony from the chairman of Hutton's Board, Robert Fomon, from Thomas Lynch, who was financial officer during the period in question and is now vice chairman of the board, from its comptroller, Michael Castellano, and from its money mobilizer, Thomas Morley.

Unfortunately, this subcommittee found it necessary to subpoena both the testimony of those four gentlemen and the documents the subcommittee believes are essential to the subcommittee's investigation.

Mr. Fomon assured us at the June 19 hearing that we would have Hutton's full and prompt cooperation in all matters relating to this investigation. I suggested to Mr. Fomon that 3 weeks should be sufficient to produce all remaining documents. Mr. Fomon asked for four, and I agreed. For 3 weeks, however, we saw hardly anything from Hutton itself, though we did read in the newspapers about a number of Hutton documents that the subcommittee had not been given. It appeared that the only documents Hutton produced to the subcommittee were those Hutton knew we had already received from other sources or that Griffin Bell had obtained and turned over to all interested parties. I found this manner of document production totally unacceptable and said so publicly last week in announcing today's hearing.

From the day the subpoena for documents was served, we were told by Hutton that most of the requested categories involved few documents and that they would be easily produced. As of last Wednesday, we had not received them.

The one area where production was likely to be voluminous was bank records. Subcommittee staff has on several occasions sought proposals from Hutton for ways the subcommittee could obtain the information it needed without requiring the company to produce documents which went beyond those needs. We have asked for preliminary documents that will help us determine how to reach that objective. Most of this material has not yet been produced.

Early this week, Mr. Fomon told me that he has retained new counsel to handle Hutton's cooperation with the subcommittee's investigation. I have the highest regard for Warren Christopher, and when I met with him earlier this week, he assured me that we have "turned the corner" on any problems we have had in the past. I believe this to be the case and am glad to hear it. In fact, he has been in daily contact with the subcommittee staff. Yesterday morning the subcommittee received another six boxes of documents, and we expect several more today.

The subcommittee seeks the cooperation of many witnesses in this matter besides Hutton. Chiefly, if we are to avoid duplicating 3 years of intensive effort, we must seek the cooperation of the Department of Justice. Justice subpoenaed millions of documents and interviewed hundreds, if not thousands, of witnesses. With its more limited resources and schedule, there is no way the subcommittee can, or wishes to, duplicate that tremendous effort. Yet to conduct a thorough oversight investigation, we must have access to Justice Department information.

Since the first day the subcommittee began its investigation, we have been in constant contact with the Department, seeking documents and other materials that are key to our effort. Since that first day, Justice has claimed that they are prohibited by rule 6(e) of the Federal Rules of Criminal Procedure from producing those materials. That rule prohibits disclosure of matters which occurred before a grand jury.

In the meantime, however, Justice has selectively released to others some of the same information we are seeking. I simply cannot understand why grand jury secrecy prohibits the Justice Department from sharing with us company and bank records which in many cases pre-date the grand jury by several years. These records did not "occur before the grand jury" to quote the language of the law. Yet in other situations—where it seems useful to Justice to release information which truly may be grand jury information—secrecy does not apply. I hope to have a satisfactory explanation today.

Justice has on a number of occasions suggested that the subcommittee seek a court order for release of the materials, citing their fear of being in violation of rule 6(e) without a protective court order. Perhaps I could more readily understand this concern if I had been shown case law justifying the Department's concern. Even so, I have significant problems about the Justice Department asking this committee to seek a court order for materials needed for the committee to conduct its legislative responsibilities for oversight over the Justice Department.

Hutton is a closed case. Justice's usual assertion that it will not turn over materials to Congress on pending investigations does not apply. This committee is entitled to the materials it has requested from the Justice Department and should not have to go to court to get them.

On a related issue, several weeks ago, this subcommittee asked the Postmaster General to assign two of the postal inspectors who investigated the Hutton case to the subcommittee to help us review the Hutton documents. We did not ask them to reveal grand jury matters to us. We simply wanted to take advantage of their expertise in the case in advising us about the relevance of the many documents we have received from our own sources. Not one sheet of paper which we asked them to review with us came from the executive branch of the Government of the United States. We didn't want that to be the case, but the executive branch of the U.S. Government, over which we are exercising a constitutional function of oversight, would not give the legislative branch of the Government documents in its possession.

Initially, the Postal Service agreed to our reasonable request. Some time later, however, we were told that the postal inspectors who worked on Hutton would not be made available because to do so would violate grand jury secrecy. Instead they offered to send us other inspectors, the sole criterion for selection of which would be total ignorance of the matter in which we sought expert assistance—the Hutton case. I fail to understand the logic of this response. It is as if we asked for a banquet speaker and got a positive response, providing they can find one with no tongue.

This subcommittee intends to conduct a thorough investigation in a conscientious manner. It will not be frustrated in that investigation. I believe that E.F. Hutton will now cooperate fully with us. As we expect to learn in more detail today, the problem is that Hutton does not have a lot of the Hutton documents, since the only copies are still in the hands of the Justice Department. I understand there may be as many as 7,000 documents delivered by Hutton—7 million documents that have been delivered by Hutton to the Justice Department as part of their criminal investigation.

Hutton, as I have indicated, didn't retain many, many of these documents. I am not even sure Hutton can tell us today how many hundreds of thousands of the documents that they have been delivering, either with or without subpoena, to the Justice Department they have retained copies of. So without Justice's cooperation, we can't possibly complete our mission in this case. That is why it is so important for us to arrive at an understanding with the Department of Justice so we can in fact proceed with this investigation.

I want to at this time welcome to the committee, before I recognize the ranking Republican on the committee, Mr. Trott, who is no stranger to the committee, along with Mr. Harrington and Mr. Swagerty of the Postal Service who will join him.

The gentleman from Florida.

Mr. McCollum. Thank you.

For a number of reasons, it has been frustrating at times to seek the documents to understand what really went on, and so on. Obviously, there are questions that arise any time we get staff to staff and member to member on this much detail, and there are obviously even more chances for misunderstanding when we find interest varied and as many employees involved in trying to produce or not produce documents.

So I am very pleased to see the hearing today clarify some of this. I would like to say at the outset it has been my experience in the process of the hearing, the Justice Department and Steve Trott, in particular, have been excessively cooperative with this committee. While there is a genuine dispute between the chairman and the Justice Department over an interpretation of a Federal rule the chairman just cited and whether or not the grand jury secrecy proceeding indeed requires the court in Pennsylvania to have an order releasing these documents, there has been no doubt at all that Steve Trott and the Justice Department have genuinely tried to work with us, and I believe they have been very sincere, and he has been very sincere in his beliefs that in fact this rule does prohibit him from releasing the documents until a court order is presented.

He also has been very forthcoming in suggesting a cooperative joint venture between the Justice Department and the subcommittee in going to the court to seek the release of the documents if, in fact, the court would grant that order.

It is my judgment, I want to hear more from him today, Mr. Chairman, and, of course, from other witnesses, but at this point, it is my judgment we ought to be proceeding in that fashion and that that in fact would be the most expeditious route for us to go, thereby clarifying all of this and letting a court decide what, in fact, the rules of criminal procedure in this case actually say.

But notwithstanding that, I want to hear what he has to say, and I don't pre-judge it completely. I just have that initial impression.

I thank all of you as witnesses for agreeing to appear today. This was a more or less voluntary appearance this time, I think, and we are really, I think, much better attuned than we were a few weeks ago on the issue. Thank you, Mr. Chairman.

Mr. **Hughes**. The witnesses on our first panel this morning are——

Mr. **Gekas**. Is it possible to make an opening statement? Just a brief statement.

Mr. **Hughes**. The gentleman from Pennsylvania.

Mr. **Gekas**. I too want to state preliminarily that although I share the chairman's insistence that we have everything available to us that can be made available to us and must be made available to us, unlike him, I am at this point satisfied that the Justice Department is well-grounded in its insistence that rule 6(e) does govern part of its action or perceived inaction in this case.

But again, as the gentleman from Florida has reiterated, we are going to just preliminarily feel satisfied with the Justice Department's position at this point and work to see whether or not whatever is left in dispute will have quick disposition, whether it be by court action or by agreement.

I thank the chairman.

Mr. **Hughes**. Any other members desire recognition for the purpose of making an opening statement?

The witnesses on our first panel this morning are Mr. Stephen Trott, Mr. Jack E. Swagerty, and Mr. Daniel J. Harrington. Mr Trott is assistant attorney general, Criminal Division, U.S. Department of Justice. He was appointed in July of 1983. He has a distinguished record as a prosecutor for Los Angeles, CA. In that capacity, he was the U.S. attorney for the Organized Crime Assistance Task Force.

Mr. Swagerty is the assistant chief postal inspector for criminal investigators. He served in many supervisory positions of increasing responsibility in the Postal Inspection Service over the years. He was the inspector in charge of the Washington Division prior to his appointment to his current position in 1984.

Mr. Harrington is a general manager of investigations within the Postal Inspection Service. He too held numerous supervisory positions in the service and served as inspector in charge of the Special Investigations Division prior to his appointment to his current position in 1983.

Gentlemen, on behalf of the Subcommittee on Crime, welcome. Pursuant to clause 1 of rule 11 and clause 1 of rule 10 of the Rules of the House of Representatives, this hearing of the Subcommittee on Crime and Committee on the Judiciary is an oversight investigation of E.F. Hutton mail and wire fraud case. Let the record indicate, pursuant to clause 2 of rule 11, copies of the rules of the Committee on the Judiciary and of clause 2 of rule 11 of the Rules of the House of Representatives have been made available to the witnesses and are available at the witness table.

Gentlemen, you have a right to counsel to assist you in the course of this morning's proceeding. Are you accompanied by counsel? The answer is no, I gather.

Mr. Trott. No, sir, I have counsel.

[Witnesses sworn.]

Mr. Hughes. Mr. Trott, you may proceed as you see fit.

TESTIMONY OF STEPHEN TROTT, ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE; JACK E. SWAGERTY, ASSISTANT CHIEF POSTAL INSPECTOR FOR CRIMINAL INVESTIGATORS; AND DANIEL J. HARRINGTON, GENERAL MANAGER OF INVESTIGATIONS, POSTAL INSPECTION SERVICES

Mr. Trott. Mr. Chairman, members of the committee, and staff, I am indeed very pleased to be with you this morning to continue discussion into an area we think is extremely important. As we have stated on a number of occasions, both to you, Mr. Chairman, and to the public, we have an extremely aggressive white-collar crime program designed to protect the economic interests of the citizens of the United States and, as you put it so well, to engender, to pursue the idea of corporate responsibility in the area where it is so important to our country.

In that respect, the Hutton case plays a key part, and I think it is very nice to notice that white-collar crime for a short time here has pushed the drug war and other things off the front pages, and I think that is as it should be. It is important to get the message out to the people in America there is a white-collar crime program, it takes these matters seriously and will pursue them vigorously in the courtrooms of the United States.

On the issues that we are here to discuss today, I am pleased to be able to address you and the members of the committee, because there appears to be a misperception as to the attitude of the Justice Department. It all surrounds, of course, the perennial problem the Justice Department has with rule 6(e), and we are no more comfortable with that problem than you. It is a devilish problem, it prevents us in many instances from explaining with clarity the reasons that we have for pursuing the courses that we pursue.

I would like to tell the committee briefly that it is not a rule that simply sits there and is an impediment, however, rule 6(e) is a rule that finds its roots in the American criminal justice traditions. It is a rule that finds its roots in the presumption of innocence, it is a rule that finds its roots in matters in the nature of the fifth amendment to the Constitution and a rule that finds its roots in the American idea that investigations of people are to be conducted in secrecy for the benefit of making sure that persons who are being investigated will not be unfairly treated if for one reason or another they are not brought to court, which, of course, is a public matter for resolution of these issues.

Mr. Chairman, you have stated both here and the other day the Justice Department has been unable to come forward with authority, either case law or otherwise, to explain this position. With your permission, I would like to touch on a few of the cases I think bear on this extraordinarily complex rule.

I think you have had a memo prepared for you I am told by counsel here that explores some of these cases, and you, yourself, in some of your statements have referred to a number of cases, and I think that is a good place to begin the dialog.

With your permission, let me refer to a couple other extremely important cases that I think explain part of the problem that we have here in turning over to you without permission of the court materials that were gathered in connection with a grand jury investigation. I might say at the outset that I know you have people looking into this as a matter of law, and we would be delighted, Mr. Chairman, either today or in the near future, to sit down and discuss with them the enormous research the Department of Justice has done in the last 5 years on this area. So they, themselves, may see all these cases are internal guidelines, rules and regulations on 6(e) and it may be helpful to them and to you to understand why this is something that—for which we have so much respect.

In order to tell you what I am referring to, the first document that contains these cases is a document entitled, "Grand Jury Secrecy Outline." This is a rather thick document prepared by an experienced USAer who worked for me in California, handed out to the advocacy prosecutor primarily so that prosecutor will understand this is a rule to be respected and this is something we take seriously. If I may turn to page 10 and refer to a section which says in general what are matters occurring before the grand jury in the *Fund for Constitutional Government and National Archives* case which is at 656 Fed. 2d, page 856, D.C. Circuit Case 1981, not a district court opinion, the court emphasized the broad construction in favor of secrecy because disclosure is the exception and not the rule.

This is a quote from the case. "It encompasses not only the direct revelation of grand jury transcripts, but also the disclosure of information that would reveal the identity of witnesses or jurors, the substance of testimony, the strategy or direction of the investigation, the deliberations or questions of jurors and the like."

Citing another D.C. Circuit case, it also upheld a lower court ruling that the following "would reveal matters occurring before the grand jury." Naming or identifying grand jury witnesses, quoting or summarizing grand jury testimony, evaluating testimony, discussing the scope, focus and direction of the grand jury investigations and identifying documents considered by the grand jury and conclusions reached as a result of the grand jury investigation.

This is case law that I am reading and that I am referring to. I hope that I am beginning to explain why we are very careful with this case law, and why we have asked the postal inspectors in terms of your request to them also to be very careful. Second, there is another case to which I would draw your attention, a case of *Iglesias* v. *The Central Intelligence Agency* quoted on page 11 of this outline. It is a D.C. case which found the following properly classified as grand jury matter:

Information which would identify the names of actual or potential witnesses, Federal employees or agencies who had access to grand jury material, parties whose records were subpoenaed before the grand jury, the criminal violations which were under consideration, documents which were subpoenaed and/or presented to the grand jury, pleadings, considerations concerning the granting of witness immunity to certain witnesses, transcripts of the grand jury testimony and the substance of handwritten notes which discussed strategy planning or specific occurrences before the grand jury.

Again this is the material that we teach our prosecutors in giving them the respect 6(e) is entitled, and in telling them how to go about these very complicated matters. Continuing from that same outline, there is a case that I think may be extremely helpful to this committee, and to the Justice Department in our pursuit of our goal to reveal to you the very most that we can about the *Hutton* case, and it is the *Stanford* case. And I think it will—I am not sure it has been supported to you, but it is one of the lead seminal cases with which we will have to cope in pursuing our goal of turning over everything we can to you with the appropriate considerations.

On page 15 of Mr. Rapace's outline, "Documentary Information Obtained by a Grand Jury," because this is in the main what we are talking about, an area of growing debate and confusion, concerns documentary information subpoenaed by a grand jury. Even where such information is sought from the person holding such material by virtue of a connection to the grand jury investigation, it can be argued that it's revelation does not necessarily reveal some secret aspect of the grand jury's investigation.

The basis of this argument is the fact that preexisting documents usually have an intrinsic value independent of a grand jury investigation. In *United States* v. *Stanford*, 589 Fed. 2d, page 285, which is a 7th Circuit opinion, agents questioned targets using previously subpoenaed employment files as well as check endorsements of the interview only.

This was upheld as follows:

> The restrictions of rule 6(e) apply only to disclosure of matters occurring before the grand jury, unless information reveals something about the grand jury proceedings, secrecy is unnecessary. Thus, when testimony or data is sought for its own sake, for its intrinsic value in furtherance of a lawful investigation rather than to learn what took place before the grand jury, it is not a valid defense to disclose the same documents that had been or were presented or being examined by a grand jury.

Going down farther in the case: "The disclosure challenged here reveals nothing about the grand jury reinvestigation." This refers to the facts in the *Stanford* case. I might interject here each one of these cases are fact-found, but the law still gives, I think, the committee and us some solace there may be an area here for finding some documents that can be turned over. The disclosures challenged here reveal nothing about the grand jury investigation and the disclosures were made only to persons legitimately connected with the documents.

The documents revealed to the defendants were not described by the agents during the interview as grand jury documents. Each defendant was shown only his or her employment file, his or her own welfare applications, and his or her own endorsement on the warrants. For this reason, the disclosure falls outside of the scope of rule 6(e). So the sweeping statements as to the law gives us some solace.

Their application of the facts gives us cause for concern. Nonetheless, this is a case that begins to open that door. Now, the cases that have been cited to you, Mr. Chairman, and which you have referred to are important cases. Unfortunately, they predate the two U.S. Supreme Court seminal cases on this case, the *Sells* and *Baggett* case, which I know you have had an opportunity to review, in re grand jury impaneled October 21, 1978, to which the case you refer is a 1981 case.

The uranium industry case is a 1979 case. The *McGrain* case, which I don't think dealt with 6(e), is a 1927 case, and *Lance* is 1980. That is not to say these cases give us no help at all. It is simply to say *Sells* and *Baggett* changed our perception of rule 6(e) and changed it dramatically. *Sells* and *Baggett* changed our perception of 6(e) so much and our internal guidelines that we issued a document called guide on rule 6(e) after *Sells* and *Baggett*.

I would be delighted to leave a copy of this with you. Again, this is not a document that closes all doors. It is a document also designed to find open doors through which people can go in order to look for this information. But this is a guide that was prepared by our Office of Legal Policy and it contains the following language in the introduction:

> On June 30, 1983, the Supreme Court decided two cases that may significantly affect the extent to which Federal prosecutors may disclose matters occurring before the grand jury to civil attorneys within the Department of Justice and to—those are the two facts—these decisions, *United States* v. *Sells* and *United States* v. *Baggett*, present enforcement problems for the Department of Justice and all other Federal agencies. Both *Sells* and *Baggett* turn upon the interpretation of rule 6(e) of the Federal Rules of Criminal Procedure.
>
> "In *Sells*, the Supreme Court held rule 6 3(i) does not entitle civil attorneys in the Department of Justice to automatic disclosure of matters occurring before the grand jury for use in a civil suit. Instead, such attorneys must obtain a court order pursuant to rule 6(e) 3(ci) authorizing disclosure of such materials.

"In *Baggett* the Supreme Court held attorneys can obtain rule 6 3(ci) orders for disclosure only if the primary purpose of the disclosure is to assist in preparation or conduct of a judicial proceeding.

The essential message of this is to tread with caution. Again, this is a rule that, as I said before, is not a rule that exists to cause people trouble, but it represents a view of the American criminal justice system on the manner in which people who are presumed to be innocent shall be treated in an investigation. And I might add that the fact that an investigation is over changes some of the focus of rule 6(e), but it does not relieve anybody from the obligation to live by it.

Essentially the position we have adopted in the Department of Justice is in the case of a legitimate question about whether or not material either is grand jury material, or whatever it has to do with rule 6(e), it is our preference to consult with the court.

The reason for that is as follows: The grand jury is not an institution that finds its existence in the Department of Justice. The grand jury is not an executive branch institution. The grand jury is an institution that comes under the complete control of the court. Although we have custody of the records to which you refer in Pennsylvania in a very carefully organized system, those records still remain as part of the grand jury investigation and subject to the control of the court.

Now, one of our particular interests in this case is that the case itself arises in the great State of Pennsylvania, and in the well-known middle district, and we have had considerable experience in the middle district of Pennsylvania with this particular matter. It came up in a case that I think could be properly argued has as much public significance as does the *E.F. Hutton* case. This was our successful prosecution of Metropolitan Edison Co. for its handling of the Three Mile Island plants that turned into the nuclear disaster. We were successful in producing a conviction of Metropolitan Edison in that case, pleas of guilty and substantial contributions to the Pennsylvania emergency fund, in addition to fines that they paid.

The Nuclear Regulatory Commission obviously had a considerable interest in what happened at Three Mile Island, and they wanted to know what happened there. We had uncovered in our grand jury investigations, and I personally was involved in that, and I agreed with the Nuclear Regulatory Commission in making sure that the people of Pennsylvania would be safe in the event of reopening of those plants and all other people would be safe if there was something that could be learned from that incident of universal application.

I Ok'd an application by the Nuclear Regulatory Commission to the court in the middle district of Pennsylvania for the release of grand jury information. We were first told by the court they weren't interested in hearing us because we were just the Justice Department, after all, and there had to be somebody there other than the Justice Department. We supported the Nuclear Regulatory Commission in an application for the grand jury material in that district. And I am sorry to say that that application was turned down.

And the reason it was turned down was not because the court felt the Nuclear Regulatory Commission did not have a legitimate interest in Three Mile Island, but it was turned down because the court believed rule 6(e) says what it means and means what it says, and I would again be delighted to share this opinion with you, Mr. Chairman, and with your legal——

Mr. HUGHES. That was a request for grand jury testimony.

Mr. TROTT. Yes. Let me——

Mr. HUGHES. Who asked for grand jury testimony?

Mr. TROTT. You have not, but it was for all grand jury matters. If you will let me continue, I will let you draw your own conclusions as to why we believe simply we are not going to give you this, but the court should be consulted.

This motion was opposed by numerous unnamed individuals who appeared as witnesses before the pertinent grand juries, here and after grand jury witnesses. My point is other people have standing in here, the people taken into the grand jury have some variety of standing in this, and they simply cannot be ignored.

The court continues in its opinion, in considering these two assertions, one, the disclosure of this information protects the public interest and, two, forcing the Commission to obtain this evidence independently would entail large and unnecessary expenditures, which is something you referred to earlier.

The court says, in considering these two assertions, this court came to the following conclusions, while it is true that the public's interest in the safe and closely regulated nuclear industry is significant, that interest must be weighed against the interest of the witness, the Department of Justice, the courts, and the public in maintaining a strong and largely inviolate tradition of grand jury secrecy. The grand jury system may lose its effectiveness if secrecy is sacrificed without the strong showing of need described above.

The court must consider whether the public can be protected, albeit in a smaller manner, by breaches of the trust under the grand jury witness testimony. The Nuclear Regulatory Commission contends many of the reasons for grand jury secrecy no longer exist. This is a factor in considering a slip around. However, the court finds the factors of retribution remain.

Additionally, we believe the chilling effect on these and future witnesses before the grand jury cannot be overlooked. In the interest of protecting both the integrity of the grand jury system and responding to the need of the public, this court suggests the NRC does its own investigation of the employees pursuant to its own subpoena power. We further suggest the NRC analyze, evaluate documents and records in its possession or obtainable from Metropolitan Edison. When and if as a result of knowledge gained in this investigation NRC is able to formulate and compose a carefully tailored request for the disclosure of records supported by a compelling need discussed throughout this memorandum, the Nuclear Regulatory Commission should repetition this court.

We stand ready to work with this Commission to put together a document showing a particularized need and arguing to the maximum extent possible within our obligation to protect 6(e) for the material that is needed by you to arrive at the conclusions that you are driving toward.

There is another very complicated aspect of this that I don't think you have been made privy to, and that is 12 U.S.C., section 3421 in the banks and banking rules and regulations, section 3420. Section 3420 says grand jury information: financial records about a customer obtained from a financial institution pursuant to a subpoena issued under the authority of a Federal grand jury shall be returned and fully presented to the grand jury; two, shall be used only for the purpose of considering whether to issue an indictment or presentment by that court or of prosecuting a crime for which the indictment or presentment is issued or for a purpose authorized by rule 6(e) of the Federal Rules of Criminal Procedure; three, shall be destroyed or returned to the financial institution if not used for one of the purposes specified in paragraph 2.4, shall not be maintained or a description of the contents of such records shall not be maintained by any Government authority other than in the sealed records of the grand jury, unless such record has been used in the prosecution of a crime for which the grand jury issued an indictment or presentment or for a purpose authorized by rule 6(e) of the Federal Rules of Criminal Procedure.

Now, I don't believe that Hutton is a financial institution, but I do believe that the banks from which hundreds of thousands of records were subpoenaed may very well be a financial institution discussed in the banks and banking regulations, and there is this particular statute that mandates that these be regarded as 6(e) information.

The reason here, obviously, is the right to financial privacy that the Congress of the United States has been so careful in protecting. That is an additional complication that we think mandates we get some direction with respect to some of the records that have been requested by you.

As I indicated before, the court has retained essential control of these documents, and the reason for that is not just because the court has nothing better to do than to have documents, but there are still legitimate purposes for which the court must maintain these records in the carefully organized manner in which they now exist.

As you know, and without blowing our trumpet, there is a restitution agreement in here that will allow not just the banks doing business in the middle district of Pennsylvania but every bank aggrieved by Hutton's activity to step forward with a master and pursue unlimited restitution. In order to allow the master to do his or her job, it is essential that those records be retained as part of the court process.

Second, the SEC has done exactly what we have suggested we would like to do with you, and that is the SEC has obtained a court order from Judge Nealan to have access to grand jury material, and the reason is because I assume Judge Nealan honored their request, it was in contemplation of a judicial proceeding. I would like to indicate, Mr. Chairman, the turn-around time on the request of the SEC and issuance of the order of Judge Nealan was remarkable. This is not asking; that take a long time.

The last time I appeared in the Senate and offered to Senator Grassley to do this, he raised a legitimate question: Are you trying to suck me off into long litigation that is going to take 2 years to resolve? My answer to him was no, I am not, but we now have the SEC experience in this case that shows Judge Nealan is going to be responsive to these kinds of things and will take them with the seriousness with which they are presented. The good news is that we can do these things quickly if we get our act together and make that application, and then we will know.

I would like briefly also, Mr. Chairman, to examine the letters that you have sent to us in connection with this case in connection with the kinds of requests you have made, because I think they bear directly on not only the *Stanford* case, but the October 2, 1978 case. Bear in mind, Mr. Chairman, I don't want anybody to construe anything I am saying in any way as being either critical of this committee or contentious or acrimonious. You have asked for the reasons, and I am trying to set these things out as best as I can.

In your letter of June 4, you indicate that you would like, in con-
nection with our case, all correspondence with and reports received
from other agencies, all documents of Hutton that bear on this
matter, all documents obtained by the Government or developed by
its activity and bank accounts maintained by Hutton during 1980
and 1985 and all analyses, workup charts, graphs of such informa-
tion, all documents including those developed by the Government
relating to cash management, practices of Hutton including analy-
ses of responsibility within the company for all development and
execution of practices in question and all analyses of issues of cor-
poration or individual criminal responsibility of the question of
filing criminal charges against individuals. It is our view some of
hese things may not exist.

When there is a request for all like this, it raises considerable
additional 6(e) problems. If you would simply turn to the case that
know that you have cited on a number of occasions as authority
or your activity in this case, the *In re Grand Jury Impanelled Oc-*
ober 2, 1978, and remember the *Stanford* case and other cases that
ay documents here, documents there, documents everywhere may
not reveal what went on before a grand jury, but everything that
oes on in a case and everything that goes into a grand jury will.

And even *In re Grand Jury Impanelled October 2, 1978,* the court
enied a request saying with respect to an inventory of all docu-
ments, the court shares DOJ's concern that producing an inventory
ill inevitably set a dangerous precedent by revealing a great deal
bout the scope and focus of the grand jury investigation.

Mr. HUGHES. May I interrupt you?

Mr. TROTT. Certainly.

Mr. HUGHES. I don't think the letter in any way suggests we
anted inventory before the grand jury. We asked for all the docu-
ents relevant to the E.F. Hutton case. That is a lot different than
king for grand jury documents.

Mr. TROTT. My legal construction of that falls squarely——

Mr. HUGHES. I don't see how you can construe it——

Mr. TROTT. The reason they denied an inventory is they said an
ventory in and of itself—"The court reluctantly concludes an in-
ntory discloses matters before the grand jury"——

Mr. **Hughes**. We have not at any time asked for an inventory. We have asked for no information relative to your grand jury proceedings.

Mr. **Trott**. In my humble opinion, an inventory is a lot less of a revelation than——

Mr. **Hughes**. I have to presume when we ask for all relevant documents, it can be much broader, first of all.

Mr. **Trott**. Well, we seem to have—I guess we may agree to disagree for the time being on that. This is simply a reason for our concern. Again, it is not a reason for denying your request, it is a reason to try to explain our suggestions to you.

Mr. **Hughes**. Is there any place in any of the correspondence or any of the discussions that we have had—we have had a number of them—bearing on the question of 6(e) where we ever asked for inventory of grand jury proceedings?

Mr. **Trott**. No.

Mr. **Hughes**. Or the strategy before the grand jury?

Mr. **Trott**. Yes.

Mr. **Hughes**. We have?

Mr. **Trott**. I believe that is——

Mr. **Hughes**. Working documents disclosing strategy?

Mr. **Trott**. The way you have articulated your request, I believe yes, it does. Because you asked for all documents bearing on the Hutton case, and there are matters in there I am confident will be in our 6(e) documents. But in any event, unfortunately, somehow we have been perceived as stonewalling the committee on this.

I would like, with your permission, to correct that impression. As you know, the Deputy Attorney General and Mr. Brady and I and you met with Mr. McCollum and some staff members earlier in June. After that meeting, at which we offered to try to find a way to resolve this complication, a letter was written to you on June 25 which was signed by Lowell Jensen.

The letter says as follows, and it puts it more articulately than I can off the top of my head:

> This is in response to your letter of June 12, 1985, concerning disclosure of materials pertaining to the Hutton case.
>
> With respect to the issue of bank supervisory agency reports, we are attempting to retrieve and make available reports prepared by Federal agencies. State agency information was obtained by grand jury subpoena, and is thus subject to Rule 6(e).
>
> As to the three broad categories of documents you request, we do not believe that all the documents are covered by Rule 6(e). However, the documents which fall into these categories number in the millions. Thus, as a practical matter, sorting the non-grand jury material from that which is covered by 6(e) is extremely time consuming. If we were to copy all those at 10 cents a page, you are talking about hundreds of thousands of dollars. For this reason, and because I am not certain the committee actually wants all of these documents, I believe it would be most productive to have members of your staff meet with members of the Criminal Division staff to come up with a more specific list of documents you need for your hearing. The Criminal Division staff will review these requests to determine if they are covered by 6(e).
>
> You can be assured that we will provide you with any material that is not covered by 6(e). However, I must emphasize the law concerning what materials are covered is not as clear as we might hope. Therefore, there may be substantial questions as to whether particular material is covered by 6(e). We believe it is preferable, indeed necessary, to submit any such questions to the U.S. District Court with jurisdiction over the grand jury. In this regard, we will defer to the court as to what can and cannot be disclosed.

In order to get this process rolling, I repeat Assistant Attorney General Trott's invitation to your staff to contact William Landers, special counsel to Assistant Attorney General Trott.

He may be contacted, and we can give his phone number.

> With respect to materials in the possession of the Postal Inspection Service, we have not instructed the postal inspectors to withhold data, but merely noted their disclosure of material should be consistent with 6(e). We will remain available to the Postal Service to assist them in determining what materials will be made available. You should be aware, given the volume of files and documents in this investigation, it will be a considerable task to segregate the non-grand jury materials you seek. . . .
>
> As to your request for memoranda or documents relating to interviews of witnesses outside the grand jury, we will seek to determine whether we have such materials in our possession. We believe that relatively few witnesses were interviewed under circumstances in which grand jury secrecy would not apply. However, we will attempt to identify all non-grand jury interviews not subject to disclosure limitations under 6(e).
>
> Pursuant to your earlier request, we are enclosing copies of the transcripts of court proceedings in Scranton on April 30 and May 1 and 2, 1985.
>
> Finally, the submission of the attorneys for Hutton and other potential defendants are available to your staff for inspection in room 836 of the Federal Triangle Building. Let me know if you have additional questions or desire to pursue any issue discussed.

I am advised by Mr. Landers we never received any phone calls. The reason I chose Mr. Landers, I have confidence in his legal ability, but, No. 2, he is an expert. He is the person we offered to Senator Grassley. We recently went to court in the Eastern District of Virginia in a similar setting with respect to materials about which we had questions and presented with the Senate jointly a request for information.

The important thing here is that we were successful, and the Senate was successful in getting this information. But the dates, I think, are extremely telling. If I can quote from the memorandum opinion in the Eastern District of Virginia: The request comes about in this way, on October 1, the subcommittee issued a subpoena addressed to Stephen S. Trott requiring the Department to produce on October 4, 1984, all prosecutors' memos, concerning the nvestigation of the companies involved, a report of the U.S. attorney, all other reports and memoranda of the U.S. Attorney's Office, t cetera.

On October 1, only 12 days later, the Department filed with this ourt a motion for determination of whether redacted portions of he documents were properly withheld. Concluding at that time here was no controversy of this court, the court on October 15 enied the motion. This is the only reason we have not unilaterally een up in Pennsylvania ourselves trying to do this for you is beause the courts turn us away as not presenting a case or controersy. We will be presenting the court a case, in the sense we will ot be the type of adversaries that go to court.

Subsequently on October 25, the subcommittee filed a motion to tervene which, among other things, we suggested reconsideration the October 15 denial. Argument was held on November 9, at hich time the court concluded it was presented with a controver-. Thus, it allowed the subcommittee to intervene, it heard arguents on the merits from counsel. At the conclusion of the argument, the Department was required to submit *in camera* inspecon. These were documents the court had never seen. The good news is the court order sanctioning the turning over these documents came out on November 20.

What I am saying is this is an example of how quickly this can be done. I don't intend this as a criticism, but I think if back in June we started on this, you might have now a determination and we might both be working on documents that have come out.

Mr. SMITH. May I interject here a moment and ask a question. Mr. Trott, you just read us about the fact there would be no controversy and, therefore, the court has turned you away, but that you will be going back there with a friendly controversy and application to the court. Since the beginning of June or earlier, this committee has heard from you, and you quoted a letter from Mr. Jensen the end of June, that your department is claiming 6(e) as the legal basis for not turning over these documents. You have had probably 2 months, but in effect at least 1 month, but apparently have made no attempt whatsoever to begin that application on behalf of the controversy which you claim is created by this committee's request.

Might you answer why it is that you feel the need to continue to wave 6(e) as a bar but have not done anything to promote the court which you claim could, in fact, give you the authority to release these documents to, in effect, bless the release of those documents by court order?

Mr. TROTT. I apologize for not having been clear on that. I was attempting to indicate, the last time we went to court by ourselves, the court told us "Go away, we are not interested in hearing from you."

Mr. SMITH. Even though a subpoena had been issued by this committee?

Mr. TROTT. A subpoena had been issued by the Senate in that case, and the court said "We are not interested."

Mr. HUGHES. I think more to the point is we have endeavored to get documents that are in the possession of the Justice Department that may or may not have relevance to the grand jury proceedings. We have asked nothing relative to grand jury proceedings. We have asked for documents, millions of documents apparently that you have taken either through subpoena or voluntarily from E.F. Hutton, and I have to presume other sources, which you have in your possession, which we can't get from those other sources because in many instances they deliver them to you not making copies of them, and you have put us in a position where as part of our constitutional oversight responsibilities we can't perform those duties.

Now, you cite a lot of cases, and I have listened here very attentively. It is the first time I have heard you cite any cases at all. I have asked you for authority for your position since early June, and every time my investigators, my staff, would ask for information even about the extent—nature and extent of the overdrafting, we got 6(e). In fact, the first letter from Mr. Jensen, June 10, indicated that 6(e) covered everything we requested.

That was modified by the June 25 letter by saying there are some things 6(e) governs and other things it does not cover. But I want to assure my colleague, who is a very learned attorney, experienced trial attorney, that we too have examined 6(e) very carefully before we embarked upon this investigation. We have done a thorough examination. We are conversant with all the cases the gentleman cited, most of which are relevant.

The *Edison* case is absolutely irrelevant. The cases the gentleman cites, *Sells* and *Baggot,* are irrelevant. We are a congressional committee investigating as part of our oversight responsibilities E.F. Hutton and the Justice Department's handling of that case.

I submit to my colleague that we have never at any time asked for any grand jury testimony. We have not asked for any testimony that would indicate strategy before the grand jury. We have asked for no list of witnesses before the grand jury. We have couched all our requests in terms of specific documents that have an intrinsic value pursuant to case law which would not trigger 6(e). We have been very careful to make our requests as broad as we have to make them to make sure we get the information we want to get, but not so broad, not so narrow that we would by the same token ascertain either strategy before the grand jury, how it was handled, grand jury testimony, or the identity of witnesses before the grand jury.

All the case law which I am aware of all talk in terms of the responsibility to release such documents where they have an inherent intrinsic value, where documents predate grand jury, where they really were not developed before the grand jury, those documents can be released if in fact they are documents that we have requested that in fact make reference to a grand jury. That is very simple.

We have always made it clear, any reference to grand jury strategy can be deleted. We understand that. We have not requested any grand jury testimony whatsoever. So I say to you, Mr. Trott, even though your office seems to be fair and reasonable, what you are, in essence, doing is you are interpreting the law in a fashion which has no basis in the law, and you are requiring this committee to go to a court to enforce its request for information when, in fact, the law, as far as this committee is concerned, the way this member reads it, and I trust that most of my colleagues read, is that we are entitled to this information.

Why should this committee have to go to the court for such an order when, in fact, we are entitled to it as a matter of right under the law as I read the case law?

Mr. TROTT. Mr. Chairman, may I ask you if any of your staff ever contacted Bill Landers, the person I offered to you, to try to work this out? I am told nobody even called Mr. Landers.

Mr. HUGHES. I don't know.

Mr. TROTT. Excuse me, Congressman Gekas did call Mr. Landers.

Mr. HUGHES. I don't know at this point what purpose that is going to serve, because at this posture, the position Justice has taken consistently with us up until the Jensen letter was anything that wasn't a matter of public record was 6(e). And it was only until June 25 that we received the Jensen letter that position was modified to some extent, but the modification really does not in my judgment get us where we want to go.

You possess millions of documents E.F. Hutton can't provide to us because they don't have them, you have. You take the position you can't give us those documents because of 6(e), citing no authority which gives you any basis to deny us those documents.

Mr. **Gekas**. Point of parliamentary inquiry. What would be the remedy of this committee if we determined that the responses of Mr. Trott to your inquiries are inadequate? Would we not have to go to court, or to cite the Justice Department as being in contempt, or to attempt to do so? How would we proceed if we remain satisfied, or some of us remain satisfied, they are indeed stonewalling? What is our remedy?

Mr. **Hughes**. I want to say this to my colleague, that is not a point of parliamentary procedure. I would be happy to respond to the gentleman's inquiry.

I am hopeful we can arrive at some understanding with the Justice Department so we don't have to weigh the alternatives. I find the suggestion that this committee seek a court mandate for documents that we are entitled to to be an unacceptable procedure. Constitutionally we are entitled to pursue our duties just as you are entitled to do your duties.

The two options are rather obvious. Either we have to accept what has been offered to us by Justice or else we have to proceed and subpoena the documents we believe we are entitled to and proceed from there.

Mr. **Gekas**. That is the point. If we continue to subpoena those documents and the Justice Department then says, "We cannot supply them," therefore, we wind up in court. We are in court for 6 months trying to do something which we could intervene now, as the one subcommittee did in the Senate, and get it within 10 days. Either way, what I am saying, the Justice Department winds up in court if it continues its position. We have no way to dissuade them from changing that position on 6(e), so we get to court either way.

I suggest, in the interest of expediency, we intervene in court now and get this information now.

Mr. **Hughes**. We are talking about some extremely important constitutional prerogatives that we would have to weigh very carefully before we decide which option. I say to my colleague from Pennsylvania, it is our hope we are not forced to make that choice. It is my hope we arrive at an understanding with Justice, based upon the law, as I understand it, so we don't have to in fact resort to legal action of any kind.

The gentleman from Florida.

Mr. **Smith**. I thank the gentleman.

Mr. Trott, you responded in response to my question that the court, with reference to the Senate subpoena, told you to basically get lost, they wouldn't entertain your petition without any other party or a controversy. The Federal Rules of Civil Procedure, as amended, rule 6, section 3(d) exceptions, reads: "A petition for disclosure pursuant to Subdivision E3(c)(1) shall be filed in the district where the grand jury convened. Unless the hearing is ex parte," which it may be when the petitioner is the Government, "the petitioner shall serve written notice of the petition upon, A, B, C, D," et cetera.

Did you cite the Federal Rules of Criminal Procedure to the presiding judge in your application for the waiver exceptions to rule

6(e), and did he deny you on the grounds that that doesn't apply, that you are entitled to an ex parte application for disclosure?

Mr. Trott. Mr. Smith, I don't know. I will have the answer to that question by this afternoon.

[The information follows:]

U.S. Department of Justice

Criminal Division

T. 7/24/85
WJL:amb

Office of the Assistant Attorney General

Washington, D.C. 20530

JUL 26 1985

Honorable Lawrence J. Smith
Member, House Judiciary Committee
Subcommittee on Crime
House of Representatives
Washington, D.C. 20515

Dear Congressman Smith:

Assistant Attorney General Trott asked me to respond to your question at the Hutton hearings concerning whether we cited the provisions of Rule 6(e)(3)(D) to the District Court in our filing regarding disclosure of grand jury material to the Senate Subcommittee on Administrative Practice and Procedure. That portion of Rule 6(e) states, in part, that the Government may make an ex parte application to the District Court for disclosure when it is "preliminary to or in connection with a judicial proceeding," as authorized by Rule 6(e)(3)(C)(i). You asked if we brought this to the attention of the District Court when it rejected our ex parte filing concerning grand jury material generated by the Newport News Shipbuilding investigation which was one of the subjects of the Subcommittee's inquiry. The answer is no, because it did not apply to the particular filing that was made.

It may not have been clear at the hearings, but the motion we filed in that matter was for a ruling by the court as to whether or not certain material which had been redacted from documents given to the Senate Committee was covered by Rule 6(e). It was not an application for disclosure under Rule 6(e)(3)(e)(i). Consequently, until the Senate Counsel filed pleadings with the District Court taking issue with our position as to what was covered by Rule 6(e), the court was of the view that it would be rendering only an advisory opinion.

After the court reviewed the questioned material, we provided revised copies of the documents eliminating redactions which were not required by Rule 6(e). The Subcommittee made no requests for material which the court ruled was covered by Rule 6(e). If there had been, Rule 6(e)(3)(D) still would not have allowed an ex parte filing by the government since disclosure to

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a Congressional Committee is not based on Rule 6(e)(3)(C)(i). Rather, it is based upon the general supervisory powers of the court, and the Subcommittee would have to be the moving party.

In this regard, the decision of the District Court concerning disclosure of grand jury material in the Three Mile Island investigation to the Nuclear Regulatory Commission (NRC) is particularly relevant to the Hutton case. It arose in the same judicial district as the Hutton case. The district court there characterized the Department's request for disclosure to the NRC as "a gratuitous proxy motion for disclosure." United States v. Metropolitan Edison, No. 83-00188, (M.D. Pa. June 25, 1985). It would not entertain a motion for disclosure until it was made by the NRC itself.

For your convenience, I have enclosed copies of our filing with regard to the Newport News Shipbuilding matter, and a copy of the decision concerning the NRC's request in Three Mile Island. I hope that this is responsive to your inquiry. If you have any further question, please do not hesitate to call me at 633-4674.

Sincerely,

William J. Landers
Special Counsel to the
Assistant Attorney General
Criminal Division

Enclosure(s)

cc: Honorable William J. Hughes
Chairman, House Judiciary Committee
Subcommittee on Crime
House of Representatives
Washington, D.C. 20515

Honorable Bill McCollum
Ranking Minority Member
House Judiciary Committee
Subcommittee on Crime
House of Representatives
Washington, D.C. 20515

Mr. **Smith**. Thank you, Mr. Chairman.

Mr. **Trott**. If I may add one thing. Our offer to you with respect to Mr. Landers was not simply to get things ready for an application to court, but I told Mr. Landers, and I thought—and if I was unclear on this, I apologize—that I expressed to you that Mr. Landers' first job, as I instructed him, would be to start examining things and come to a conclusion as to which things weren't 6(e) in our judgment so those we could start turning over right away as we worked with you to determine the kind of things you were interested in.

Mr. Landers was there for two purposes. He is here today for two purposes, to sit down with you and start hammering away at this request for all documents and call out those we believe we will be able to give you. Then with respect to those about which there is a problem, we will go to court.

Mr. **Hughes**. Mr. Trott, we have a basic problem, and that is that you structured in such a way the production of documents that we are not going to get the information that we think is relevant by the way you structured it.

Mr. **Trott**. It is certainly not our intent to do that.

Mr. **Shaw**. Mr. Chairman.

Mr. **Hughes**. Just a second. Let me follow up this one line of thought.

Up until now, we have made a request for a lot of documents, a lot of information, and a lot of the work product of the Justice Department, which I presume never went to the grand jury, such as memos on meetings between Al Murray and others preparatory to strategy in the case, whether to accept a plea or prosecute individuals. That is all relevant, as you know, to this investigation. We have requested all that information, and we have received none of that.

Some of this falls entirely without—it seems to me it is not even arguable—6(e).

Mr. **Trott**. I hate to be contentious, but strategy memos frequently contain factual references that come out of matters developed by testimony in a grand jury.

Mr. **Hughes**. You have made it clear you can easily delete that material. References to grand jury you delete.

Mr. **Trott**. And Mr. Landers will sit down and start working on that. One of the problems is that some of these deletions—I know this is true in the October 2 case—result in a document that thick having two pages left that are not blank.

Mr. **Hughes**. The point is one of the central issues before this subcommittee is whether or not the Justice Department acted in the public interest in opting not to prosecute individuals.

There were a number of meetings preparatory to the final acceptance to the plea, the decision to accept the plea, from corporate defendant on 2,000 counts. We should have had those particular memoranda 1½, 2 months ago. That certainly is well outside the scope of 6(e).

Mr. **Shaw**. Mr. Chairman.

Mr. **Hughes**. The gentleman from Florida.

Mr. **Shaw**. Thank you.

I think we are getting ahead of the issue here. We haven't got a clarification on what the issue is. I think it appears, from the information that we have received from Mr. Trott, from your comments and comments from the staff, that we have a great deal of work we can do to find whether there is an issue. If there is a case, there are documents we feel we are entitled to that the Justice Department feels are covered by 6(e), let's go get them together. If we find the Justice Department, or we feel there is a coverup or they are stonewalling us, I can assure you, you will receive full cooperation from this side of the aisle in working our will upon the entire system to get what we are entitled to.

I don't think we have defined the issue at this point. I think we need more staff work and more time to exactly find out where we are and whether we are bumping heads. I am not sure that is necessary.

Mr. **Hughes**. I would grant the gentleman, we need additional staff work. I mean the documents are absolutely overwhelming, and it makes it much more difficult because we have to fight for the documents that we are now able to secure. But insofar as what the law suggests on this subject, I think I understand the law as well as anyone. I believe I do. I have heard no case law that supports the Justice Department's position.

Now, it may very well be we have some areas where we can effect compromise. We have been trying. We have had a series of discussions. I personally have sat down with Mr. McCollum, Trott, and Jensen in trying to arrive at some framework. To date, we have not been able to arrive at any understanding. But I find unacceptable any interpretation the Justice Department would suggest because documents have been subpoenaed for a grand jury, automatically 6(e) attaches. That, in essence, is the position of the Justice Department.

The gentleman from Connecticut.

Mr. **Morrison**. Thank you. I want to state the view that this—the way that we are presented with the issue by the Justice Department, I think, makes it impossible for us to proceed until we clarify this issue. We are being told by asking for all the documents, which makes no reference whatsoever to any strategy or any differentiation between what has been taken to the grand jury and what has not, we implicate all the documents that went to the grand jury and that can't be given. Any attempt beyond that to differentiate, we will be told that would show the strategy because we are differentiating.

I think it is quite clear. All the documents can be disclosed without revealing to us what the strategy was except to the extent specific documents make reference to that strategy, and the Justice Department has control over the manner of disclosure to avoid any disclosures of the strategy.

Mr. **Hughes**. Would the gentleman suspend.

[Recess.]

Mr. **Morrison**. My concern is that we cannot go to court asking or 6(e) permission without conceding that we believe that 6(e) aplies, and yet we have structured our request precisely along the ines to avoid the effect of 6(e), so the notion we can try to go off to ourt and solve this problem——

Mr. **Shaw**. Will the gentleman yield?

I suggest we amend our letter and ask for all documents not covered by the protection of 6(e) and then take a look at that and then come back and try to get the rest.

Mr. **Morrison**. Reclaiming my time, the witness has already told us that everything is covered by 6(e) in essence, because we asked for all of it.

Now, my concern, and I have a question, if I might ask the witness, my question for Mr. Trott is this: You seem to be putting the burden on this committee to determine what it is that we have to ask for in order to avoid the effect of 6(e). I don't understand when you get a request for all, it seems to me the exception to all is those documents that are covered by 6(e). So you should disclose to us everything not covered by 6(e) and say we cannot disclose the remainder as a result of 6(e), and then if we want to go to court and ask the court to give us those additional documents on the ground that it is an exception to 6(e), we can do that.

But that is not the way you are proceeding. You are essentially saying, you come in and describe for us—and we have all the documents, we know what they all say, you don't know anything about which ones they are—you come in and describe for us the exception. I don't understand that is an appropriate way to proceed; 6(e) is clearly an exception. It should be a small amount of documents. You are treating it like it is all the documents.

Mr. **Trott**. Mr. Morrison, you have just put your finger on one of the problems I tried to elucidate. If I may briefly read to you from our manual and from a case—you have underscored, and you have, too, Mr. Chairman, how you want all the documents. Let me tell you what the problem with that is and why we have offered to sit down and work inside that request.

> Second, a request for documents under this theory logically becomes more vulnerable to attack as the number of documents sought increases. The court in re: Grand Jury Disclosure 550 Fed. Supp. 1171 emphasized the problem as follows: Every subpoenaed document reviewed by the grand jury will reveal to some extent what occurred before the grand jury. At the very least, information on the direction of the grand jury's investigation or perhaps the names of persons involved in the grand jury's investigation will be apparent. It is inconceivable that the disclosure of nearly 40 boxes of subpoenaed documents would not reveal what occurred before the grand jury. Indeed, it is likely that the disclosure of 40 boxes of subpoenaed documents will reveal all about the focus and scope of the grand jury investigation.

That is why we have offered to sit down and work within the——

Mr. **Morrison**. That can only be true if we know it went to the grand jury. Otherwise, no one knows. Because these documents, if they can be secured, if we can get them from Hutton, nobody knows what went to the grand jury. The only way in which we have a problem is if you tell us they went to the grand jury.

Now if you are telling us every document in your possession went to the grand jury, then we have the problem. Now, did every document in your possession relating to E.F. Hutton go to the grand jury?

Mr. **Trott**. I believe—and remember this, when somebody tries to call me on it later, because I was not the prosecutor on this case, I did not subpoena the documents and I have never been before this grand jury—but I believe that the documents that came from

Hutton were all subpoenaed for the grand jury and fall within that gamut.

Mr. **Hughes.** That wasn't the question.

Mr. **Morrison.** Did all the documents in your possession relating to the E.F. Hutton case go to the grand jury? All internal memos, all the matters you have gotten since the grand jury concluded its proceedings, all of that went to the grand jury? All of that is proceedings of the grand jury?

Mr. **Hughes.** Do you understand the question? The question is: Did the grand jury that was impanelled receive all the documents, all the documents subpoenaed?

Mr. **Trott.** I don't know the answer. I don't know exactly what went in or didn't.

Mr. **Hughes.** I wouldn't expect you to answer, but I would submit to you probably the answer is no.

Mr. **Trott.** Mr. Hughes, I am advised the material in Pennsylvania was secured by subpoena to the grand jury. Let me just indicate in this connection what we have made available already—we have made available to case prosecutors for briefings of the staff of this and other committees of Congress, and we have reviewed in detail the evidence presented to the court of the rule 11 proceeding. These briefings were held as early as May 10 at 2 o'clock, and there was one later on in May. We made Al Murray available and Peter Clark available——

Mr. **Morrison.** Excuse me. These are not documents, these are discussions with members of your staff.

Mr. **Trott.** I would like to review what we have.

Mr. **Morrison.** I understand. I am just asking—what you have just cited, they are not documents, they are interviews with people.

Mr. **Trott.** They are case prosecutors. We have given you all the court documents we have, including the transcripts. We have responded to numerous requests for further information. I am told we gave our home phone numbers to the staff so they could review the information given in briefings. We have made available submissions made by Hutton and various other officers and employees over the objection of Hutton. Some of those we have not gotten back. We offered to assist the committee staff in preparing an application for a 6(e) order.

So some of the material you are referring to that might not fall within the——

Mr. **Hughes.** Would the gentleman yield to me——

Mr. **Trott** [continuing]. Has been turned over.

Mr. **Hughes.** To date, the Justice Department has exercised rule 6(e) for everything except public documents.

The problem is a very simple one. I hear the Justice Department saying they are not stonewalling, they want to cooperate. I hear them saying they really want us to have this information. I also hear them saying, "All we can give you is the public documents with some exceptions. We are not sure what they are, because it would be an awful job trying to sort through the millions of documents we have." Hutton tells us they can't comply entirely with the production of certain documents because they have turned them over, not making copies, to Justice. Justice tells us they can't give us the documents because 6(e) attaches.

We have a constitutional responsibility to do a complete and thorough job. I would submit if, in fact, we were to complete this oversight investigation without looking at all these documents, the first thing somebody would say is "You didn't look at all the evidence." In fact, we didn't look at any of the evidence that perhaps Justice would consider pertinent because Justice has the documents.

Now, we haven't asked for any grand jury testimony—I am not going to repeat this, I am tired of hearing myself—we asked for nothing that would indicate what went before the grand jury. We don't want any grand jury testimony, we don't want to know who testified before the grand jury. We don't want to know the witnesses, we don't want to know the prosecutor who presented the matter, we don't want the strategy before the grand jury. We don't want any references to grand jury testimony.

We have in our request drafted it so we follow the case law right down the line. I know of no cases whatsoever anywhere in the United States that have been decided that run contrary to the position taken by the subcommittee.

Mr. McCollum. Mr. Chairman, may I be heard?

I think we are at an absurd point. I am amazed after Jensen's letter that our staff—the majority staff conducting this matter has not made any contact with Mr. Landers to try to work this out. It seems to me, from what Steve Trott has been telling us this morning, there has been total, open-door cooperation on the part of the Justice Department with respect to this. Most of these documents the chairman is concerned about would have been up here long before now if that extra step had been taken. I really didn't know until today we hadn't made those steps. I just find that absurd.

I would like to say, with all due respect to the chairman, because I know it is not his intent to do this, this whole hearing, this whole process is beginning to take on a picture for the public of a partisan political witch hunt against the Justice Department. I know that is not your intent, but it just doesn't seem to me necessary to be haranguing Mr. Trott as we are doing today when he has really opened every door to us, as I am hearing him say. I didn't come in here prepared to argue it this way. It is very clear that we have the opportunity to get all kinds of documents from Justice without anything more than our staff going down and talking to Mr. Landers and bringing an opportunity for Justice to say, "OK, here they are."

Isn't that right, Mr. Trott?

Mr. Trott. That is exactly our attitude, Mr. McCollum. I apologize to the chairman if he hears me saying anything else.

Mr. McCollum. Isn't it correct, once that is done, we can then proceed if we have an argument still over what is left, and that is where we would be and we would expedite all that?

Mr. Trott. Mr. Landers has done this before. He has been over these hurdles.

Mr. McCollum. It seems to me we are making a mountain out of a molehill.

Mr. Hughes. Will the gentleman yield?

The gentleman is a relatively new ranking Republican on this committee. I have been chairman of the committee now for over 4 years, and that is the first time any members have suggested this committee has been partisan. I want to say, in all due respect to my colleague from Florida, he is absolutely being very unfair. My colleague received the same letter from Lowell Jensen I did. Lowell Jensen laid down in our meeting and also in the letter the same thing we were told at our meeting where the gentleman was in attendance what the ground rules were going to be, written by the Justice Department. The ground rules were unacceptable. The gentleman heard me. I have consistently told the Justice Department that their interpretation of 6(e), in my judgment, runs contrary to the law and is unacceptable.

How the gentleman can make that partisan is beyond me. And the gentleman, I think, knows it. I take exception to the gentleman's exception that it is partisan.

Mr. McCollum. If I may reclaim, Mr. Chairman, what I said, I don't believe for 1 minute you are partisan in this. What bothers me—and I don't think the gentleman has frankly thought this through before today's hearing—is that the public is going to have the impression all the members on this side are over here defending the Justice Department and all the members on that side are slamming them. It is becoming apparent——

Mr. Morrison. Will the gentleman yield?

Mr. McCollum. It doesn't have to be this way. It is an absurd position we are in.

Mr. Hughes. Will the gentleman yield?

Mr. McCollum. In just a moment.

It seems to me it is such a simple thing, and there is no controversy that should be here. We shouldn't be in the position of giving an impression to the public there is some partisanship going on—that is what we are doing. We don't want to, but we are—and there is lack of cooperation on the part of the Justice Department. There isn't in this case. I would be the first to stand up and say there have been, but not in this case.

Mr. Hughes. Will the gentleman yield? It reminds me of one of my first courses in law school: "When the facts are against you, you argue the law; when the law is against you, you argue the facts; when both are against you, you just argue."

Let's start talking about the law—my colleague is a good lawyer—and let's talk about legal precedent. If the gentleman from Florida can present to me legal precedent for the position of the Justice Department, I would be happy to receive it. We have sought legal precedent all along from the Justice Department. Today was the first time I heard the Justice Department cite any cases to me—today.

Mr. Morrison. Frankly, if I were out in the public reading the papers, I would think that the only focus of this investigation was E.F. Hutton. That is what has been in the paper and the public domain. And while there is plenty of questions to be asked about an E.F. Hutton, we really have a responsibility here to learn about the policies of the Justice Department and the decisions of the Justice Department with respect to this case.

Quite frankly, when the Justice Department erects what seems to be an insurmountable barrier with respect to getting information about how the Justice Department handled this case, the suggestion is that what the Justice Department is doing is not protecting itself from liability for contempt under 6(e) but protecting itself from criticism from the way it handled the case, and that is what gives the appearance there is something more here than merely following the rule.

I don't think that is a partisan matter. I think this committee has a responsibility to determine why it is that what seems to be a rather limited result in this case obtained rather than something more.

Mr. McCOLLUM. Would the gentleman yield?

Mr. MORRISON. I would be glad to yield.

Mr. McCOLLUM. I am not suggesting it is a partisan matter. I am suggesting until I brought it up, the appearance was going out to the people filming this that it was we had such a big case, we were not getting documents, there is a lot of frustration involved in this process, today we are taking it out to what appears to be a partisan matter. It isn't even a legal problem necessarily. It is an unwillingness or pride on the part of our people to get with their people at Justice and get the documents available. Just go down and get them. That is all we need to do.

Mr. MORRISON. If I can reclaim my time. I think we have stipulated now this is not a partisan matter, and we ought not to be discussing that. Let's get back to the question at hand, which is how are we going to get through what appears to be a thicket? And I think the chairman has stated it quite clearly, I think we are being presented with a catch-22. If we ask for this in any way that suggests a differentiation of documents, we are going to be told the differentiation gives rise to questions under 6(e), and we asked for all the documents, we can't do any of that because that would give rise to a 6(e) problem. I think that is what we are hearing from Mr. Trott.

Mr. TROTT. In our letter, we said as to the broad categories of documents you request, we do not believe all are covered by 6(e). We said "Call Mr. Landers."

Mr. Chairman, with all due respect, I told you and talked to your staff—I thought we would get a call from Mr. Landers the next day, after my conversation with your staff. I was surprised the call did not come.

Mr. HUGHES. That is a lame reason not to produce documents to this committee. There are hundreds of documents at this point that the Justice Department has relevant to this inquiry. Justice has followed this inquiry as closely as anyone else, and they know the documents we have sought. And you have produced no documents whatsoever aside from the public documents that have been released. That is all you have produced for this committee. We have asked for these documents.

The dilemma the gentleman puts us in is—first of all, I don't agree with the interpretation of the law. The gentleman has produced no case law supporting the Justice position. If, in fact, we were to follow the gentleman's—let's assume we followed the gentleman's suggestion, we follow it the way you structured the way we are going to get the documents and we went to court and we acknowledge that that is the procedure, it does set, in my judgment, a terrible constitutional precedent. We have to go to court to get what we are entitled to. We acknowledge the fact we have to go to court and the court turns us down—in my judgment, this committee has a very important constitutional oversight responsibility——

Mr. TROTT. Is that what you are fearful of? That is what we are fearful of also. We would just as soon have it happen before hand rather than have our neck in a noose.

Mr. HUGHES. It seems to me you are in the horns of a dilemma.

Mr. TROTT. Yes, we are.

Mr. HUGHES. What you have done is forced us to proceed in another fashion, which is to subpoena the documents, then proceed from there, if documents are not produced, to a contempt of Congress citation. So it seems to me that we had better be talking about the case law and make sure that, in fact, we have got all the case law to support the position, because that is the position you are forcing this committee to pursue.

Mr. TROTT. I can't adopt your characterization of that, Mr. Chairman, because it is not our desire to force anybody. It is not our desire to derogate from the authority or the responsibilities of this committee. It is simply our responsibility, as officers of the court, as lawyers, as members of the Justice Department who are controlled by rule 6(e), to make sure we don't violate it. In case this committee thinks rule 6(e) is not taken seriously, other aspects of grand jury secrecy have resulted in the firing of a U.S. attorney and his prosecution and conviction for contempt. These are not things we take lightly.

Frequently—and I mean every month—I get a call from irate judges around the country furious about leaks from grand jury material. We are told in no uncertain terms that is our ball game, not yours. All I am saying is we are attempting to take seriously our responsibility, and in doing that, we are offering up a solution to a dilemma that you accurately described to us and the committee to work this out. Mr. Landers will be able to identify for you——

Mr. HUGHES. It seems to me, Mr. Trott, it is a self-imposed dilemma. There is no case law that you cited that would support your position.

The gentleman from Florida.

Mr. SHAW. Mr. Chairman, I would like to ask Mr. Trott a question. Your statement about arguing the law encouraged me to go back and read 6(e). Under section 6, are we talking about sealed records? That reads,

> Records, orders and subpoenas related to the grand jury proceedings shall be kept under seal to the extent and for such time as necessary to prevent disclosure of matters occurring before a grand jury.

Is that the area you are concerned about?

Mr. TROTT. That is essentially it.

Mr. SHAW. It occurs to me what you are saying is that 6(e) under this section applies to subpoenaed records, as well as the records that actually went before the grand jury. Is that correct?

Mr. TROTT. It very well may. In some instances, it does. It depends.

Mr. SHAW. I think that is the problem, Mr. Chairman. You have been talking about the records that went before the grand jury, and obviously this tremendous amount of records was never shown to the grand jury, never read to the grand jury. There wouldn't be enough hours in years and years to have gone before the grand jury. Mr. Trott seems to be concerned about the ruling of 6(e), and I actually share his concern.

Mr. **Hughes**. If the gentleman would yield. Case law is very clear, consistently. Just because documents have been subpoenaed by a grand jury does not make them fall within the prohibitions of 6(e). The case law is very clear, if documents have an intrinsic value independent of their production to the grand jury, whether they went to the grand jury or not, they can be produced. If documents have been subpoenaed or requested for this type or other types of hearing which make reference to the grand jury in the context of the document, the Justice Department knows they can obliterate that particular reference to the grand jury and produce that document, as long as it doesn't disclose what went before the grand jury.

There is nothing we have done that would indicate if we got the documents that went before the grand jury. We have couched our subpoena in such a fashion we do not trigger 6(e) under the case law.

Now, if Justice had some legal authority to support their position, that would be one thing, but they don't have any legal authority. I have heard no legal authority cited, as I have indicated until today. The legal authority that has been cited really isn't relevant to this proceeding.

Mr. **Trott**. What is your answer to the 40-box doctrine that says if you cough up all 40 boxes, by definition, that reveals what went on before the grand jury and violates 6(e)? In the case that you, yourself, cite, it says an inventory necessarily reveals—an inventory.

Mr. **Hughes**. We haven't asked for an inventory.

Mr. **Trott**. You have asked for all documents.

Mr. **Hughes**. Mr. Trott, the Justice Department, I have to presume, has done the same thing that this committee has done. We subpoena a lot of documents. We have probably 300,000 documents that we have sifted through with the assistance of the General Accounting Office. We might have 25 relevant documents, 25. We had to go through it box by box, item by item, memo by memo, and determine what was relevant and what was not relevant. Ninety-five percent of what we viewed pursuant to our subpoena were not relevant.

Now, I have been involved in enough grand jury cases to know you subpoena much more quite often than you really need because you quite often don't know what you need. We are talking about bank records, we are talking about memorandums, we are talking about correspondence. We are talking about a lot of documents that—and I would submit that probably compromises the bulk of the documents that you have. I would suspect that probably more than 50 percent of the documents that you possess have very little relevance to the case.

So how you can suggest that in some way will tell us what went before the grand jury is beyond me. If we had asked you for an inventory of what had went before the grand jury, you would have a legitimate reason to exercise 6(e). We haven't done that.

Mr. **Trott**. Congressman, I apologize for my lack of clarity in my presentation. I am not saying "no." I am simply asking this committee to see its way to doing what we did with the Senate, and that is go to the court. I appreciate your concerns if the court says "no," somehow you might feel that your authority has been unnecessarily curtailed.

Mr. **Hughes**. It would be.

Mr. **Trott**. We are between the horns of a dilemma, we are between the court and the Congress.

Mr. **Hughes**. Mr. Trott, it would be under those circumstances. The constitutional prerogatives of this body would be undermined if that were to occur.

Let me suggest a further way to proceed. We have other witnesses——

Mr. **Mazzoli**. Mr. Chairman, the main event has yet to go on. I am getting a little bored with all this.

Mr. **Hughes**. Let me submit a proposal which I think we have alluded to, which I think will get us off center. We will have to do battle perhaps on the constitutional issue another day so we can move on, without conceding it.

Why don't you simply produce for us all the documents you have that 6(e) won't attach to, and then we will do battle over the balance of the documents. There are a lot of documents you have, and I have alluded to some of them, memorandums that you have prepared for decisionmaking in the Department, which never went to Justice, documents that do not fall within the provision of 6(e), and then I would think you would have to provide us the identity of those documents you can produce under 6(e) and the reason for that, and we will have to take that up at another time.

Mr. **Gekas**. Mr. Chairman, will you yield?

Mr. **Hughes**. The gentleman from Pennsylvania.

Mr. **Gekas**. I respectfully move at this time this committee intervene in the matter at hand and go to and file motions, the relevant and proper motions, in the Middle District of Pennsylvania to secure the documents that this committee requires.

What this procedure would accomplish——

Mr. **Hughes**. I say to the gentleman that the motion is not in order.

Mr. **Gekas**. May I ask why?

Mr. **Mazzoli**. The chairman says it is not in order.

Mr. Chairman, if I could maybe take a few seconds. I have been relatively quiet today.

Mr. **Gekas**. Will the gentleman yield? I would like a clarification as to why that motion——

Mr. **Hughes**. Because members were apprised the purpose of the hearing today was to take testimony.

Mr. **Gekas**. I see.

Mr. **Hughes**. The gentleman from Kentucky.

Mr. **Mazzoli**. I have a couple comments. I am getting a little bored by this anyway. I think most people are. I think we ought to move on to the main event.

Let me say with respect to Mr. Trott, I don't expect you to come into this room groveling and asking some kind of favor of this committee. I also don't like to be preached to and lectured at. I think that is what you were doing today. I would just respectfully and fondly and familiarly advise you that really doesn't work too well. You make your point. The point has to be made from your standpoint, but it can be made two or three different ways.

Let me say it does seem reasonable what the chairman has said, if you are between the horns of this dilemma, it seems to me you can extricate yourself very easily by turning over en masse all of the documentation. If I understand it all correctly, this esoteric, arcane argument we have had today, it is simply the fact if Hutton had copies of those documents, they would, pursuant to the chairman's request, have turned those over to this committee already. It just seems to me obvious.

Mr. Fomon and his people, if they are serious about getting to the heart of the problem, can make a request of you to turn over all of the materials we don't have copies of and you promptly turn over to Hutton everything and they, as a third party, turn it directly over to this subcommittee, is that too much to ask? Where is the 6(e) problem with that?

Mr. TROTT. Mr. Congressman, you have just raised an interesting idea. Without the opportunity to think it through carefully, I will tell you what I will explore, and that is the possibility of, if Hutton is willing to bear the expense of copying all the documents that they gave to us that they did not keep copies of and we could return those copies to them, then they, of course, are not bound by 6(e) and can do anything.

Mr. MAZZOLI. That is precisely the case.

Mr. TROTT. I think it is very possible you may be onto something here. I would be delighted to discuss that with my legal counsel.

Mr. HUGHES. Will the gentleman yield? Are any of the documents at this point such that you could return them to E.F. Hutton entirely?

Mr. TROTT. This is the other problem. As I indicated, there is a specific need for these documents in Pennsylvania. They are now under the court's control with respect to the SEC order. They are needed for the restitution program.

Mr. MAZZOLI. I will leave to the brilliance of all the——

Mr. HUGHES. Let me——

Mr. MAZZOLI. Mr. Chairman, if I could. I leave to—there are many brilliant lawyers in your employ down at the Justice Department and brilliant lawyers on this subcommittee and the Hill. If you are serious about helping this committee to do their job and if Hutton is serious about getting to the heart of this check-kiting scheme, it seems to me there is a way out of this thing. You can, finesse 6(e) easily by just getting the documentation back. Because we will know what it was used for, whether it was in a corner the whole time, whether it was presented to a grand jury. If the parties here are serious, I think there is an easy way out of it. If there are technical objections, if you raise all kinds of constitutional objections, obviously any kind of objection is going to fail.

I just would respectfully make that observation. To my untutored mind, there does seem to be a way out of this. I would hope you can get together. I am getting tired of this.

Mr. **Trott.** It may be a brilliant stroke. I was unaware, until a number of days ago, Hutton had not kept copies of documents that were turned over, and I will sit down this afternoon and take a look at this. If Hutton will bear the expense of copying those, we may.

Mr. **Mazzoli.** You said something about trashing. Well, in view of what E.F. Hutton has been doing, I don't think you are trashing anybody by giving the records back that they might be made public at all.

Mr. **McCollum.** I am delighted with the suggestion. I had a note down here to ask about that when we got caught up in all this. I think cost is a factor here we didn't discuss this morning. Somebody is going to have to pay these costs.

Mr. **Mazzoli.** If you will yield back to me a moment. I don't think cost should be a factor here. There are millions of dollars that have been kited and messed around with all over this country. I think if the parties are serious, if they say it is going to cost too much, I would say that goes to the bona fide of their willingness to——

Mr. **McCollum.** If the gentleman would yield, I agree with respect to E.F. Hutton. We are talking about taxpayers' dollars. It is the funds we appropriate.

Mr. **Mazzoli.** It is a factor. It shouldn't be the supreme factor.

Mr. **McCollum.** It shouldn't be, I agree.

Mr. **Hughes.** Let me suggest to Mr. Trott, take a look at that possibility. Obviously, cost is going to be a factor. I still offer the other proposal; that is, identify the documents that do not fall within the prohibition of 6(e). We should have those anyway. Deliver those to us. Identification of documents where 6(e) attaches, and then we will take it from there.

Mr. **Shaw.** I would like to bring up one other point.

Mr. **Hughes.** The gentleman from Florida.

Mr. **Shaw.** With regard to 6(e) and the documents themselves, particularly those E.F. Hutton did not make copies of, I would assume they are entitled to have access to those documents for purposes of copying them to get copies for themselves back. Is that not correct?

Mr. **Trott.** Maybe. I don't know.

Mr. **Shaw.** Perhaps E.F. Hutton could give us the necessary consent to go in and make those inspections. I don't think we want $100,000 worth of xerox copies. I think what we should do is look through the documents and see what we want and then copy them. It could be E.F. Hutton would also give us their consent to go forward. That might even simplify the procedure further.

Mr. **Trott.** That plays back into the problem we had before. It is not just interest of E.F. Hutton, it is the interest of all witnesses and everybody else. But I will explore this. It is a fine idea. We may be able to do it. What we will do is continue to approach this as we have tried to in the past, and that has been part of the solution to this rather than part of the problem.

I apologize if I come off as preaching. That is just my style, it is not my intent.

Mr. **Morrison**. Mr. Chairman, I don't want to get lost—and I don't think it is lost in your suggestion—but I don't want to get lost at this point. The documents that are not original documents subpoenaed from E.F. Hutton but internal Justice Department documents relating to the handling of this case, that problem is not going to be solved by the good suggestion from the gentleman from Kentucky. That has to be dealt with under the chairman's suggestions. And I would hope many of those documents—to the extent that strategy with respect to the grand jury has to be obliterated, that is one thing—should be producible, and I would hope they would be.

Mr. **Trott**. We suggested your suggestion in our June 25 letter, and we will continue to do that. All we were doing was inviting your staff into the process to focus and get rid of the irrelevancies and get to the heart of what you want.

Mr. **Hughes**. What time frame do you envision would be a reasonable time frame for you to begin delivering to us the documents that do not fall within the prohibition of 6(e)? And that would include what I have alluded to before and my colleague from Connecticut just referred to, documents that do not bear upon the grand jury.

Mr. **Mazzoli**. Mr. Chairman, may I——

Mr. **Hughes**. Let me finish my statement, please.

Documents that Justice has in its possession that bear on the decisionmaking that went into the plea.

Mr. **Trott**. I will provide those to you as soon as possible. I don't know what the universe of them is or the availability of the people, but it will be as soon as possible, without delay, and in good faith.

Mr. **Mazzoli**. Mr. Chairman, I was going to say, I am not nearly as interested in why the Justice Department withheld prosecution of certain people and why they agreed to this plea bargain or whatever it was called. I am much more interested in just exactly who was responsible for ordaining this check-kiting scheme. I can't believe it was done by these mid-level people. I believe it goes to the top. I am less interested as to why Mr. Trott did what he did, because there is prosecutorial discretion, there are factors I am not sure I am competent to get into, but that is a fact this committee is entitled to get into, and we should.

But I don't think we should be getting these two things intertwined, because the one side is going to be defensive about showing us why they did something. They will not be as defensive about turning over records allowing us to go into the check-kiting scheme.

I would hope that we would be able to keep these compartmentalized so the Justice Department and Mr. Trott could help us get the documentation. What bears upon why they did what they did is, I think, a very important chapter, but subsidiary to the main event.

Mr. **Hughes**. The gentleman is right, but unfortunately we have to proceed on two tracks, and both tracks are important to this committee's mission. Thank you, Mr. Trott.

Mr. Swagerty, the only area that I have any concerns about really is when—and Mr. Harrington—when we first requested the assistance of the postal inspectors who had worked on the E.F. Hutton case, the response was that you would produce the postal inspectors and go through the documents we had received independently.

Then I presume there was some consultation with Justice and a second letter came into my office indicating that you could not provide us with postal inspectors that had any expertise working in the E.F. Hutton case because rule 6(e) would be prohibitive.

My question is, perhaps you can explain to me how providing personnel from your office, working with my staff, sifting through bank records, will in any way trigger a violation of 6(e).

Mr. **Swagerty**. If I may, I would like to identify Mr. Charles Braun. He is with us in addition to Mr. Harrington. In addition to consultation with the Department of Justice, certainly we did consult with our own legal counsel. There was a decision made initially to provide that inspector to you. I apologized after that decision was made. It was further considered, after consultations, as I said, with the Department of Justice and with our own counsel and with the inspector involved, and we did reverse our decision, and I do still support that decision at this time.

We are taking the position that the inspector's analysis of that would be based in whole or in part on knowledge he has gained by appearing in the grand jury.

Mr. **Hughes**. Appearing in the grand jury or working through documents——

Mr. **Swagerty**. Appearing in the grand jury, working as an officer of the grand jury.

Mr. **Hughes**. I have to assume, Mr. Swagerty, your postal inspectors had to go through a number of bank accounts, a number of statements, reconciliations, including the zero-balance account maintained by E.F. Hutton. How would the expertise gained from the knowledge of E.F. Hutton's workings reflect in any way what went on before the grand jury?

Mr. **Swagerty**. If I may, several weeks ago, one of the inspectors did appear before some of the staffers on the committee, and there were some questions posed to that inspector, and I would like to say most of those questions that were asked of him he politely declined to answer, because he did draw such a relationship. Again, we are taking the position that because of the complexity, because of the magnitude, because of the many, many times and because of the number of documents involved here, there is just no way that the inspector could separate——

Mr. **Hughes**. Mr. Harrington, what your inspectors gained by and large was a knowledge of the workings, the internal workings, financial workings, of E.F. Hutton. Was that knowledge gained in talking with Hutton employees, going through Hutton documents that would be of assistance to us? My question is how that in any way suggests what went before the grand jury.

Mr. **Harrington**. The position we are taking is anything he might become involved in with a subcommittee would cross over that line.

Mr. **Hughes**. Is it your position because some of the documents were subpoenaed from E.F. Hutton, that in fact triggers rule 6(e)?

Mr. **Harrington**. I don't think we are relying on a particular defense. It is more a matter the man worked over a period of years in an investigation as an agent of the grand jury, and that is how he acquired most of his expertise about that matter. For that reason, we have offered a different inspector who didn't have that grand jury assistance, without a court order, and we have also offered, if a court order can be obtained, to cooperate to the full extent.

Mr. **Hughes**. Would you agree if we were to accept the order and take on a postal inspector who had no knowledge of the workings, they would be at a disadvantage because the inspectors who worked on the case spent a great deal of time just understanding the financial workings?

Mr. **Harrington**. These are able people and can get up to speed very quickly.

Mr. **Swagerty**. I believe they would not be encumbered, would not have that in mind. If you would give us the opportunity, we will provide an inspector or inspectors that are very qualified, and I believe we could show you very soon we could assist you.

Mr. **Hughes**. Mr. Shaw, the gentleman from Florida.

Mr. **Shaw**. No questions.

Mr. **Morrison**. No questions.

Mr. **Hughes**. Thank you very much.

We thank you, gentlemen. We appreciate your testimony.

Our next witness this morning is Mr. Robert M. Fomon, chairman of the board of the E.F. Hutton Group, Inc.

Once again, on behalf of the Subcommittee on Crime, welcome.

The committee will stand in recess for 1 minute.

[Recess.]

Mr. **Hughes**. The subcommittee will reconvene.

Our next witness is Mr. Robert M. Fomon, chairman of the board of the E.F. Hutton Group, Inc.

Mr. Fomon, once again, on behalf of the subcommittee, we welcome you.

Let the record indicate, pursuant to clause 2 of rule II of the House of Representatives, copies of the rules of the committee have been made available to the witness and are available at counsel table.

Mr. Fomon, you have a right to counsel to assist you this morning. Are you accompanied by counsel?

TESTIMONY OF ROBERT M. FOMON, CHAIRMAN, E.F. HUTTON & CO., INC., ACCOMPANIED BY WARREN CHRISTOPHER, COUNSEL

Mr. **Fomon**. Yes. I am accompanied by counsel, Mr. Warren Christopher.

[Witnesses sworn.]

Mr. **Hughes**. You may proceed as you see fit.

Mr. **Fomon**. Mr. Chairman, members of the committee, when I appeared on June 19, I pledged on behalf of E.F. Hutton & Co., to cooperate fully with your investigation. I am here today to say that we have kept that pledge.

We believe we have now made substantially full compliance with the committee's request for documents. The delivery of documents is being completed today. Apparently, a few offices or individuals may not have completed their production, and these materials will be supplied without delay. If you have further questions about this document production, Tom Rae, our general counsel, will be appearing when I am finished.

In addition to the document requests, the subcommittee staff asked to visit Hutton's New York offices and interview people from all levels of Hutton management—from the president of the firm to business analysts. Hutton made available the 15 individuals requested by the staff, and between July 1 and 3, the staff conducted their interviews in our offices in New York.

Some individuals were questioned 15 minutes; others as much as 2 hours. Our employees have made every possible effort to respond to the committee's investigation, and I pledge that we will continue to work with your committee and your staff.

In conclusion, Mr. Chairman, let me summarize the situation from our point of view. For 3 years, until May 2, we were deeply involved with the Department of Justice and grand jury investigations. The factual situation, as the chairman noted when I was here before, was extraordinarily complex.

The investigations involved practices that were in an uncharted legal area. They covered a wide spectrum, from clearly proper practices to those which in hindsight were clearly improper.

At the end of the investigation, we faced a very difficult decision as to how to plead to the indictment. After carefully weighing a host of factors, we agreed to plead guilty and U.S. District Judge Nealon accepted that plea. His decision closed the criminal proceedings.

On our part, the plea entailed an agreement to pay $2 million in fines, to pay the cost of the Government's investigation, and make restitution to banks which suffered losses as a result of our activities. We also accepted a broad civil injunction which spelled out for the first time the ground rules for our cash management practices. We are abiding by that injunction and have already taken steps to implement it.

With this background, you will understand that we come before this committee as a company that has paid a heavy price for our past behavior. We were prosecuted in accordance with law and have suffered a painful and lengthy public penalty. That, in turn, makes us a company with two abiding missions.

One is to learn how this could have happened in the first place, and who was responsible. Our determination on that score is so strong that, as you know, we retained Judge Bell to conduct a thorough and independent investigation. That investigation was and would be underway even if this subcommittee's interest did not exist, because we want the answers.

I am anxiously awaiting the results of this investigation so that we can take the necessary corrective actions within the company. It would not be appropriate for me to speculate or prejudge the results of that investigation, and I ask you to understand that fact as you conduct these proceedings.

But we also must not and will not neglect our second mission—which is to get on with the job of serving our customers, our shareholders and the public. This matter has involved a tremendous diversion of our time and creative energies. We respect the oversight and legislative role of this committee, and I assure you that we will continue to cooperate in every respect. But we do look forward to the time when we can refocus our efforts on our business activities.

E.F. Hutton is a strong company with a long history and commitment to excellence. Our 17,000 employees are good, dependable, honest, and dedicated people. We believe we will come through this experience stronger, and with a deepened resolution to be superior corporate citizens.

Mr. HUGHES. Thank you very much, Mr. Fomon.

I just want to tell you—and I have said it before, but I will repeat it—I think that you are sincerely attempting to comply with the committee's subpoena. I just am aware of the fact that you have had some problems internally collecting some of the documents. I am familiar with that. I regret that E.F. Hutton did not seriously get on with the business of collecting these documents, producing them, until about July 12.

As a matter of fact, the first telex that went out to the offices, as you probably know, indicated they should sit on the documents, even though the document had been subpoenaed. It was not until July 12 a serious effort was made to start collecting documents.

Are you reasonably confident at this point that all the documents that we have subpoenaed will be produced today, save for the documents that we have heard about ad nauseam today that the Justice Department has?

Mr. FOMON. Would you rephrase that?

Mr. HUGHES. Yes.

In other words, aside from the documents that Justice has, which they have taken from E.F. Hutton, which E.F. Hutton has not maintained copies of, aside from those documents, as of today, will E.F. Hutton have fully complied with our subpoena?

Mr. FOMON. My instructions to employees have been to fully comply with the subpoena. If any new documents appear, I will see they are turned over to you immediately. But, in the course of producing virtually millions of documents, it is not unlikely in human experience that performance will fall short of absolute perfection.

Mr. HUGHES. I understand. We have made an exception for the bank records which are voluminous in nature. We understand that. We are working with your attorneys in trying to get samples.

But, aside from the bank records and aside from the documents that Justice has, you are fairly confident that, to the best of your knowledge, all the documents will have been produced as of today?

Mr. FOMON. To the best of my knowledge, all of the documents will have been produced.

I would prefer you direct that question to Tom Rae. I understand there are still some five offices from which we do not have documents, and he can explain the circumstances under which that has occurred.

Mr. HUGHES. Mr. Fomon, we have run into the exercise of attorney-client privilege in a number of instances, exercised by counsel. Are you familiar with those instances where we have not been furnished information requested, where an exercise of attorney-client privilege has been made?

Mr. FOMON. Well, I am familiar, I believe, with one instance relating to the Arthur Young documents. But, as you know, I am not a lawyer; I do not understand attorney-client privilege. And I would appreciate it if you would address that question to Warren Christopher.

Mr. HUGHES. To Mr. Rae? OK.

We finally received the organizational chart that we had requested at the initial hearing, and other information that we have received would suggest that the organizational chart that this committee received might be somewhat different than the organizational chart that was produced for your counsel, Griffin Bell.

Can you tell us whether or not there is a difference in those two organizational charts?

Mr. FOMON. There were no organizational charts printed as such that I am aware of during the period under discussion. Those charts were reconstructed for Griffin Bell and for you, and there may be some difference in them. I have not compared them.

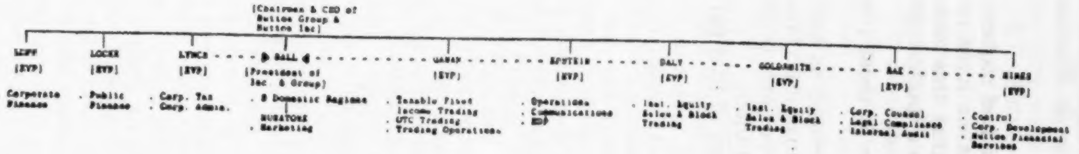
Mr. HUGHES. Any reason why we can't receive a copy of that particular organizational chart?

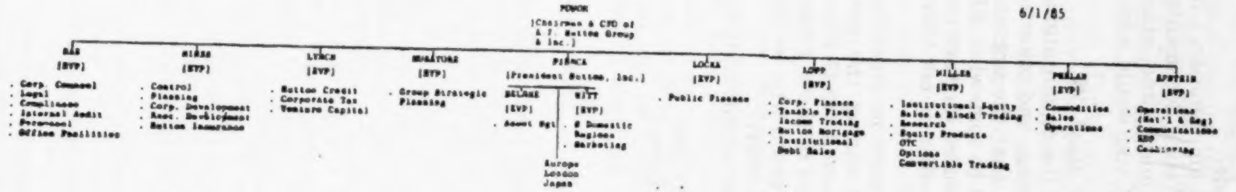
Mr. FOMON. The one submitted to him?

Mr. HUGHES. Yes.

Mr. FOMON. Yes, you can.

[The information follows:]


[Chairman & CEO of Hutton Group & Hutton Inc]
LEFF [EVP] · Corporate Finance
LOCKE [EVP] · Public Finance
LYNCH [EVP] · Corp. Tax · Corp. Admin.
BALL [President of Inc. & Group] · 8 Domestic Regions
MURATORE · Marketing
GANAN [EVP] · Taxable Fixed Income Trading · OTC Trading · Trading Operations
EPSTEIN [EVP] · Operations · Communications · EDP
DALY [EVP] · Inst. Equity Sales & Block Trading
GOLDSMITH [EVP] · Inst. Equity Sales & Block Trading
RAE [EVP] · Corp. Counsel · Legal Compliance · Internal Audit
SINES [EVP] · Control · Corp. Development · Hutton Financial Services


FOMON [Chairman & CEO of E. F. Hutton Group & Inc.]
6/1/85
RAE [EVP] · Corp. Counsel · Legal · Compliance · Internal Audit · Personnel · Office Facilities
SINES [EVP] · Control · Planning · Corp. Development · Reec. Development · Hutton Insurance
LYNCH [EVP] · Hutton Credit · Corporate Tax · Venture Capital
MURATORE [EVP] · Group Strategic Planning
PIERCE [President Hutton, Inc.]
BELKNE [EVP] · Asset Mgt.
WITT [EVP] · 8 Domestic Regions · Marketing
Europe London Japan
LOCKE [EVP] · Public Finance
LEFF [EVP] · Corp. Finance · Taxable Fixed Income Trading · Hutton Mortgage · Institutional Debt Sales
MILLER [EVP] · Institutional Equity Sales & Block Trading · Research · Equity Products OTC Options Convertible Trading
PHELAN [EVP] · Commodities · Sales · Operations
EPSTEIN [EVP] · Operations (Nat'l & Reg) · Communications · EDP · Cashiering

[PROVIDED ONLY TO GRIFFEN BILL]

12/31/81	12/31/82 and current	
N. Epstein Exec. VP Managing Director	N. Epstein Exec. VP Managing Director	
- R. Ross Sr. VP Cashier	- R. Ross Sr. VP Cashier	R. Genin Sr. VP Trading & Regional Operations (1)
- T. Morley First VP Money Management	- T. Morley First VP Money Management	Regional Operations Regional Operations Officers Branch cashiers and Branch operations managers (2)
- M. Vacca Vice President Cash Control	- M. Vacca Vice President Cash Control	

(1) Prior to divisionalization, regional operations was straight line to the regional officers. With divisionalization, there was a dotted line to regional officers and a straight line to Mr. Genin.

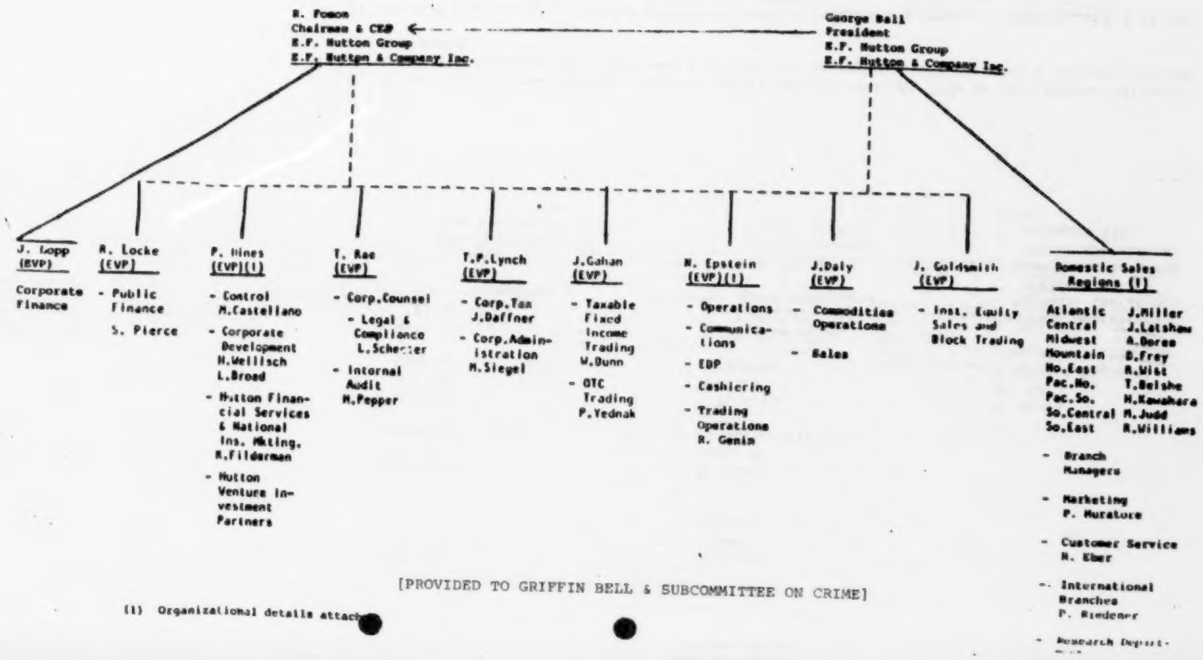
(2) In 1971 a certified branch operations manager program was begun. Currently, 60 % of the branches ~~with more than ——— brokers~~ have CBOMs.

[PROVIDED ONLY TO GRIFFEN BELL]

RAIT: 6/21/85 - SUBJECT TO REVISION

EXECUTIVE ORG IZATION

Prep on 6/21/85
as of
December 31, 1981


R. Fomon
Chairman & CEO
E.F. Hutton Group
E.F. Hutton & Company Inc.
George Ball
President
E.F. Hutton Group
E.F. Hutton & Company Inc.
J. Lopp (EVP)
Corporate Finance
R. Locke (EVP)
- Public Finance
S. Pierce
P. Hines (EVP)(1)
- Control
M.Castellano
- Corporate Development
H.Wellisch
L.Broad
- Hutton Financial Services & National Ins. Mkting.
R.Fildarman
- Hutton Venture Investment Partners
T. Rae (EVP)
- Corp.Counsel
- Legal & Compliance
L.Schecter
- Internal Audit
M.Pepper
T.P.Lynch (EVP)
- Corp.Tax
J.Daffner
- Corp.Administration
M.Siegel
J.Gahan (EVP)
- Taxable Fixed Income Trading
W.Dunn
- OTC Trading
P.Yednak
N. Epstein (EVP)(1)
- Operations
- Communications
- EDP
- Cashiering
- Trading Operations
R. Genin
J.Daly (EVP)
- Commodities Operations
- Sales
J. Goldsmith (EVP)
- Inst. Equity Sales and Block Trading
Domestic Sales Regions (1)
Atlantic J.Miller
Central J.Latshaw
Midwest A.Doren
Mountain D.Frey
No.East R.Wist
Pac.No. T.Belshe
Pac.So. H.Kawahara
So.Central M.Judd
So.East R.Williams
- Branch Managers
- Marketing
P. Muratore
- Customer Service
R. Eber
- International Branches
P. Riedener
- Research Depart-

[PROVIDED TO GRIFFIN BELL & SUBCOMMITTEE ON CRIME]

(1) Organizational details attach

E.F. HUTTON & COMPANY INC.
1981 ORGANIZATIONAL CHARTS

CORPORATE/DIVISIONAL STRUCTURE

CORPORATE HEADQUARTERS

- Operations
- Corporate Development and Control
- National Retail Marketing
  - President's Staff

REGIONAL OFFICES

- Atlantic
- Central
- Midwest
- Mountain
- North East
- Pacific North
- Pacific South
- South Central
- South East

ROVIDED TO GRIFFEN BELL & SUBCOMMITTEE ON CRIME]

1981 CORPORATE HEADQUARTERS ORGANIZATIONAL CHART

OPERATIONS

Norman M. Epstein - Executive Vice President/Managing Director Division Head Operations

- Vincent Pica - Vice President, Manager MIS
  - Gerard Vilbig - Assistant Vice President, Manager EDP Audit Control
- John F. Newe - Vice President, Manager Data Processing and P & S
  - Peter Sicoli - Vice President, Manager Computer Operations
  - Walter Pilipiak - Department Manager P & S
  - John Ahern - Department Manager - Data Entry-Card Control
    - Jack Guilino - Section Manager, Name & Address Coding
- Bernard Weinstein - First Vice President, Manager Communications & Order Room
  - Natesh Mohan - Vice President, Manager Communications Services
    - -Quotation & News Service Section
    - -Voice Communications Section
  - John Carozza - Assistant Vice President, Manager Domestic Communications Systems
    - -Communications Systems Section
    - -Technical Control Center
  - Walter Petrilla - Assistant Vice President, Manager International Communications Systems
  - Michael Cervasio - Assistant Vice President, Manager Communications Planning
  - Martin Konrad - Assistant Vice President, Manager Communications Planning
- Susan Lem - First Vice President, Manager Programming Administration
  - Harold Reynolds - Vice President, Manager Programming Administration
- Ronald Cook - Vice President, Manager Communications & Systems Programming
- James Navagh - Vice President, Manager Systems & Procedures
    - -Forms Control & Design Section
    - -Documentation & Control Analysis Section

Robert Ross - Senior Vice President, Head Cashier

- Stanley Levine - Assistant Vice President, Staff Assistant to Head Cashier
- Albert McCoy - First Vice President, Manager Security Processing
  - Vincent Lembo - Vice President, Manager Security Custody/Clearance
    - -Security Custody Section (1AVP)
    - -Security Custody Control Section
    - -Syndicate Operations Section (1AVP)
    - -Security Clearance
    - -Special Processing Section
  - Frank Ciavarella - Assistant Vice President, Manager Transfer/Corp. Reorg.
    - -Transfer Section (1AVP)
    - -Corporate Reorganization
  - Hensley Munn - Assistant Vice President, Manager Cashiering Control
    - -Security Control Section
    - -Mutual Fund/Option Control Section
    - -Buy-Ins/Fail Control
- Thomas P. Morley - Vice President Money Mobilizer
- Michael T. Vacca - Vice President, Manager Money Market Instruments/Cash Control
  - -Cash Control Section
  - -Money Market Instruments Section

- Richard Genin - Senior Vice President, Manager Trading Operations
  - Joseph Karcich - First Vice President, Manager Trading Operations
    - Richard Schuber - Assistant Vice President, Manager Equity/Debt Trading Operations
      - -OTC Reconciliation Section
      - -OTC Trade Coordination Section
      - -Non-taxable Debt Reconciliation Section
      - -Taxable Debt Reconciliation Section
    - Erwin Kirchgaessner - Assistant Vice President, Manager International Trading Operations
    - Douglas Fuge - Assistant Vice President, Manager International Credit/Customer Service
    - Albert DiGrazia - Department Manager Government Clearance
  - Norman Chaleff - Assistant Vice President, Manager Trading Systems and Control
  - Wayne Fieldsa - Assistant Vice President, Manager Regional Liaison
- Paul Underwood - Senior Vice President, Manager Operations Services
  - Steven Neiss - Vice President, Manager Dividends/Bond Interest & Hutton Financial Services Operations
  - Robert Ferrentino - Assistant Vice President, Manager Margin Monitor
  - Moosa Salman - Assistant Vice President, Manager Branch & Customer Relations
    - -Branch Relations/Lost Security Section
    - -Monthly Investment Plan Section
    - -Security Section (1AVP)
  - John Dellosso - Assistant Vice President, Manager International Institutional Margin
  - Elizabeth Siano - Assistant Vice President, Manager Stock Loan
    - -Stock Loan Section
    - -Stock Loan Compliance Section (1AVP)
  - Fred Wilson - Department Manager Stock Record

1981 CORPORATE HEADQUARTERS ORGANIZATIONAL CHART

CORPORATE DEVELOPMENT & CONTROL

- Paul G. Hines - Sr. Vice President, Corporate Development & Control
  - Hans Wellisch - First Vice President, Manager Corporate Development
    - Lee Broad - Vice President, Manager Corporate Development
      - Linda Curtiss - Assistant Vice President, Manager Corporate Development
        - -Business Analysis Section

      - John Auman - Corporate Development Associate
      - Ellen Grober - Corporate Development Associate
      - Kenneth Hoffman - Corporate Development Associate
      - Linda Rossi - Corporate Development Associate
      - Margaret Zulich - Corporate Development Associate

- Michael Castellano - Sr. Vice President, Corporate Controller
  - Lawrence Volpe - Vice President, Assistant Controller
    - Barry Skalka - Manager Internal Reporting
      - -General Accounting Section
      - -Management Reporting Section
    - Ian Wise - Manager International Reporting
    - John Cicerello - Manager Accounting Control
    - Richard Carbone - Manager External Reporting
      - -Regulatory Reporting Section
      - -External Reporting Section

Thomas Lillis - Vice President, Assistant Controller

Gary Morabito - Manager of Cost Control

Frank Miller - Assistant Vice President, Manager Retail Business Accounting

Louis Milazzo - Assistant Vice President, Manager Accounting Services

-Interest/Brokerage Section

-Bank Accounting & Control Section

-Accounts Payable Section

John Tuosto - Assistant Vice President, Manager AE Accounting/ Payroll

-AE Accounting Section

-Payroll Section

David Hoyle - Vice President, Manager Trading Accounting & Analysis

Alan Holzer - Assistant Vice President, Manager Government & Corporate Accounting

Daniel Precious - Assistant Vice President, Manager Financial Analysis

-Budgeting Section

William Flaherty - Manager Accounting Systems

David Causer - International Controller (London)

Robert Filderman - President, E.F. Hutton Financial Services (Houston)

David Scott - Vice President, National Product Manager

James McDonough - Vice President, National Insurance Director

Paul Gonzalez - Vice President, Controller

John Hagerty - Vice President, Director - National Tax Shelter Investments

Larry Laws - Vice President, Assistant Director National Tax Shelter Investments

1981 CORPORATE HEADQUARTERS ORGANIZATIONAL CHART

George L. Ball - President

NATIONAL RETAIL MARKETING

- Peter Muratore - Executive Vice President, National Retail Marketing
    - Allison Byrne - Vice President, Manager Product Marketing
        - Frank Cennamo - Assistant Vice President, Product Promotions
        - Robert Sharkey - Assistant Vice President, Retail Public Relations
        - Charles Reisler - Assistant Vice President, Retail Advertising
    - Robert Bredin - Vice President, Director of Sales Development
    - Alan Dick - Vice President, Manager Incentive/Travel
    - James Lockwood - First Vice President, Consulting Services Group
    - Thomas McInerney - First Vice President, Mutual Funds Sales
    - Maynard Engel - First Vice President, Personal Financial Management & Financial Perspective
    - Lawrence Winston - Senior Vice President, Tax Shelter Sales
    - Richard Landau - Senior Vice President, Product Origination

PRESIDENT'S STAFF

- E. Robert Eber - First Vice President, National Client Sales Development
- McKean Carmichael - Vice President, Advertising & Corporate Services

REGIONAL OFFICER LISTING

ATLANTIC

DECEMBER 31, 1981

REGIONAL VICE PRESIDENT	Jerome Miller
REGIONAL SALES MANAGER	Jerome Lichtstein
REGIONAL OPERATIONS MANAGER*	Arthur Jensen
REGIONAL CASHIER**	Hugh Van Hengel
REGIONAL MARGIN MANAGER	Louis LaRossa

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* These individuals had a dual reporting responsibility to the Regional Vice President and to Richard Genin, Senior Vice President - Operations, who reported to Norman Epstein, Managing Director - Executive Vice President - Operations.

** These individuals had a dual reporting responsibility to the Regional Operations Manager and to Robert Ross, Senior Vice President - Cashier, who reported to Norman Epstein, Managing Director - Executive Vice President - Operations.

REGIONAL OFFICER LISTING

CENTRAL

DECEMBER 31, 1981

REGIONAL VICE PRESIDENT	John Latshaw
REGIONAL SALES MANAGERS	Ernest Dippel
	Gary Irish
REGIONAL OPERATIONS MANAGER*	Michael Wallace
REGIONAL CASHIER**	Betty Smith
REGIONAL MARGIN MANAGER	James Simms

---

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REGIONAL OFFICER LISTING

MIDWEST

DECEMBER 31, 1981

REGIONAL VICE PRESIDENT	Herbert Doree
REGIONAL SALES MANAGER	Robert Frugoli
REGIONAL OPERATIONS MANAGER*	Michael Goldstein
REGIONAL CASHIER**	Joseph Alioto
REGIONAL MARGIN MANAGER	Peter Raymond

---

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REGIONAL OFFICER LISTING

MOUNTAIN

DECEMBER 31, 1981

REGIONAL VICE PRESIDENT	Dale Frey
REGIONAL SALES MANAGER	Paul Butt
REGIONAL OPERATIONS MANAGER*	Joseph Padilla
REGIONAL CASHIER**	Maureen Volkerding
REGIONAL MARGIN MANAGER	Lenny Farber

---

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** These individuals had a dual reporting responsibility to the Regional Operations Manager and to Robert Ross, Senior Vice President - Cashier, who reported to Norman Epstein, Managing Director - Executive Vice President - Operations.

REGIONAL OFFICER LISTING

NORTH EAST

DECEMBER 31, 1981

REGIONAL VICE PRESIDENT	Robert Witt
REGIONAL SALES MANAGER	S. Paul Crabtree
REGIONAL OPERATIONS MANAGER*	Robert O'Neil
REGIONAL CASHIER**	Edward McNally
REGIONAL MARGIN MANAGER	Thomas Bonner

---

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REGIONAL OFFICER LISTING

PACIFIC NORTH

DECEMBER 31, 1981

REGIONAL VICE PRESIDENT	Thomas Belshe
REGIONAL SALES MANAGER	Robert Mullin
REGIONAL OPERATIONS MANAGER*	Robert Mencer
REGIONAL CASHIER**	W. Robert Hein
REGIONAL MARGIN MANAGER	Hal Tudisco

---

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** These individuals had a dual reporting responsibility to the Regional Operations Manager and to Robert Ross, Senior Vice President - Cashier, who reported to Norman Epstein, Managing Director - Executive Vice President - Operations.

REGIONAL OFFICER LISTING

PACIFIC SOUTH

DECEMBER 31, 1981

REGIONAL VICE PRESIDENT	Herbert Kawahara
REGIONAL SALES MANAGERS	James Cliffton
	Alan Goldstein
REGIONAL OPERATIONS MANAGER*	Robert Mencer
REGIONAL CASHIER**	W. Robert Hein
REGIONAL MARGIN MANAGER	Hal Tudisco

---

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** These individuals had a dual reporting responsibility to the Regional Operations Manager and to Robert Ross, Senior Vice President - Cashier, who reported to Norman Epstein, Managing Director - Executive Vice President - Operations.

REGIONAL OFFICER LISTING

SOUTH CENTRAL

DECEMBER 31, 1981

REGIONAL VICE PRESIDENT	Michael Judd
REGIONAL SALES MANAGER	Titus Harris
REGIONAL OPERATIONS MANAGER*	Gerald Weber
REGIONAL CASHIER**	Ned Farah
REGIONAL MARGIN MANAGER	Stuart Johnson

---

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REGIONAL OFFICER LISTING

SOUTH EAST

DECEMBER 31, 1981

REGIONAL VICE PRESIDENT	Ralph Williams
REGIONAL SALES MANAGER	Clifton McIntire
REGIONAL OPERATIONS MANAGER*	Joe McAdams
REGIONAL CASHIER**	Sandy Miller
REGIONAL MARGIN MANAGER	Ron Erickson

---

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** These individuals had a dual reporting responsibility to the Regional Operations Manager and to Robert Ross, Senior Vice President - Cashier, who reported to Norman Epstein, Managing Director - Executive Vice President - Operations.

Mr. Hughes. Thank you.

We first learned yesterday, when we received a copy of a memorandum from Thomas Rae dated January 19, 1983, that there was an audit requiring all documents relating to banking activities for the period January 1, 1981 to December 31, 1982.

Did you know about that audit?

Mr. Fomon. No, I do not.

Mr. Hughes. You did not?

The reason I asked is because the request was made that all financial documents, memoranda, and correspondence was requested to be sent by all the branches to a central location back in 1983. And I would surmise that if, in fact, we had access to those documents, that would have probably supplied much of the information that this committee sought.

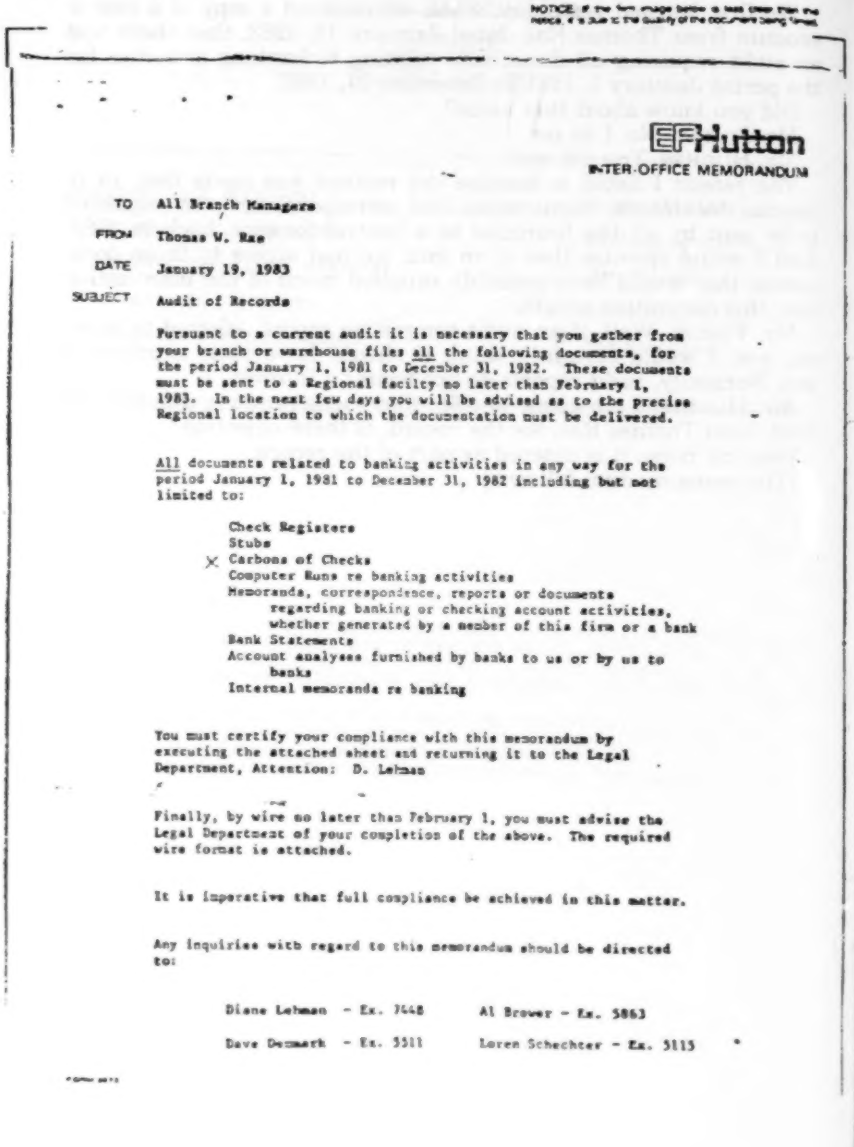
Mr. Fomon. Well, if an audit committee report referred to interest, yes, I would certainly think it should have been supplied to you. Normally, audit reports do not focus on interest.

Mr. Hughes. I am going to offer that memorandum, January 19, 1983, from Thomas Rae, for the record. Is there objection?

Hearing none, it is entered as part of the record.

[The memorandum follows:]

NOTICE: If the film image below is less clear than this notice, it is due to the quality of the document being filmed.



EFHutton
INTER-OFFICE MEMORANDUM

TO All Branch Managers

FROM Thomas W. Rae

DATE January 19, 1983

SUBJECT Audit of Records

Pursuant to a current audit it is necessary that you gather from your branch or warehouse files all the following documents, for the period January 1, 1981 to December 31, 1982. These documents must be sent to a Regional facility no later than February 1, 1983. In the next few days you will be advised as to the precise Regional location to which the documentation must be delivered.

All documents related to banking activities in any way for the period January 1, 1981 to December 31, 1982 including but not limited to:

- Check Registers
- Stubs
- X Carbons of Checks
- Computer Runs re banking activities
- Memoranda, correspondence, reports or documents regarding banking or checking account activities, whether generated by a member of this firm or a bank
- Bank Statements
- Account analyses furnished by banks to us or by us to banks
- Internal memoranda re banking

You must certify your compliance with this memorandum by executing the attached sheet and returning it to the Legal Department, Attention: D. Lehman

Finally, by wire no later than February 1, you must advise the Legal Department of your completion of the above. The required wire format is attached.

It is imperative that full compliance be achieved in this matter.

Any inquiries with regard to this memorandum should be directed to:

Diane Lehman - Ex. 7448
Al Brower - Ex. 5863
Dave Desmark - Ex. 5511
Loren Schechter - Ex. 5115

Mr. HUGHES. The gentleman from Florida.

Mr. McCOLLUM. Mr. Fomon, you heard the testimony a while ago with Mr. Trott here; am I correct?

Mr. FOMON. Yes.

Mr. McCOLLUM. During the end of that testimony, there was discussion with the gentleman from Kentucky about the possibility of producing documents back to you from the grand jury proceedings. It is my understanding that Hutton has been trying to get the originals or some of the originals back.

Is that your understanding?

Mr. FOMON. Well, again I would want to refer that question to—I would prefer you address that question to Warren Christopher. I do not really understand the implications of doing that.

Mr. McCOLLUM. Mr. Christopher, is there an ongoing discussion, or is this a new idea completely to get documents back from Justice, or copies of documents from Justice?

Mr. CHRISTOPHER. Let me say three things, Congressman.

First, if the proposal that was made is one that is acceptable to the Department of Justice, we will be glad to cooperate with that, if that will break through the dilemma or break the logjam.

Second, counsel for the company has requested the return to the company of the documents we furnished to the grand jury. That is pending—that request is pending, as I understand it, before the court at the present time.

In addition, we have requested that the grand jury documents also be made available to Judge Griffin Bell in connection with his investigation. Those matters are pending unresolved before the court.

The main thing I want to emphasize is our willingness to cooperate if there is some mechanism by which those documents which we don't have copies of can be returned to us, and then could be turned over to the court—turned over to the committee.

Mr. McCOLLUM. What about the problem of costs involved here? I know that is an issue that concerned us. We have a budgetary constraint; you have a budgetary constraint. I know you have not had a chance to think about that. That was raised 1 minute ago.

I don't know whether we are talking about all $7 million or something much smaller that could be reasonably borne by the company. It appears Mr. Trott is saying the court, for the master's purpose, has to keep a lot, if not all, of these documents that they have; and it would be copies that have to be produced back to you.

Would that be prohibitive, or do you have any idea?

Mr. CHRISTOPHER. Up to this point, Congressman McCollum, Mr. Fomon has given instructions that costs shall not be an inhibiting factor in our producing documents for the committee.

I would further say, though, that the reason Hutton did not retain copies of many of the documents that were given to the grand jury is that they were too voluminous to copy originally. I am not sure that those will be ones that will be of great interest to the committee staff at the present time. I think the most useful thing I can say at the present time is that we will work with the committee in trying to cut through that problem, if it is acceptable to the Department of Justice.

Mr. McCOLLUM. I appreciate that response.

I yield to the gentleman from Florida.

Mr. FOMON. May I add to that response?

A great number of those documents, I believe, that the grand jury has are in the form of canceled checks, which they were part of their proving the scheme, the dishonest practice. I don't really think that your committee is interested in those financial records.

I think what you really want are copies of memoranda among employees.

Mr. MCCOLLUM. Well, I think, Mr. Fomon, there is a desire perhaps to see some of these; I don't know. I would hate to have us on record today making that clear-cut distinction, because you never know where a canceled check could corroborate a date somewhere that would be material to our understanding of what transpired in terms of the internal workings and knowledge of the people who, you know, we are concerned in your shop might or might not have known or should have known.

But I am not saying that staff counsel might not work that out. I don't really know. It just occurs to me to respond that I wouldn't want that to go by, with all due respect.

I will be glad to yield.

Mr. SHAW. I thank the gentleman.

Was any type of inventory kept by E.F. Hutton of the documents that you did not keep copies of?

Mr. FOMON. Again, I would hope that you would save that question for Tom Rae.

Mr. SHAW. Neither one of you gentlemen——

Mr. FOMON. I do not know.

Mr. SHAW. If there is such an inventory, I would assume you would have no problem with supplying us with a copy of it. It might help us to reconcile our records to see what is over there that we might want that we can't get from Justice.

Mr. CHRISTOPHER. Do you want me to respond, Mr. Chairman?

Mr. HUGHES. Please.

Mr. CHRISTOPHER. My understanding—of course, I am just beginning to learn about this matter—my understanding is there are basically two categories of documents turned over to the grand jury, of which Hutton does not now have copies. First are the very voluminous bank records, and the failure to retain copies of those was deliberate, advertent, simply because they were too numerous to copy.

There is a second category of documents which were turned over to the grand jury which Hutton apparently does not have copies of. Those are memoranda, letters, other correspondence or materials. The failure to keep copies of those was inadvertent.

I think there is probably a fairly good indication of the character of documents which we turned over, but did not keep copies of. That is the first category, where we deliberately didn't keep copies. I doubt that there is a very good index or a very good way to determine the nature of the documents which we did not keep copies of, where the failure to keep copies was inadvertent.

Mr. MCCOLLUM. If I might reclaim my time, I would like to comment that while I could explore here, as we did the other day, a lot of intricacies, it is not my intent to do that, Mr. Fomon, or Mr. Christopher.

I am delighted the company has brought Mr. Christopher aboard; that the cooperative spirit appears to be coming aboard to this degree.

I am hopeful this whole issue of production of data can be behind us so that the committee can go on, as I know E.F. Hutton must be, to the examination of the facts rather than discussing the procedure and the paperwork description.

I appreciate it very much, Mr. Chairman.

I will yield back at this point.

Mr. HUGHES. Before I recognize the gentleman from Connecticut, I just want to say, Mr. Fomon, that even though we are very interested in memoranda and correspondence, there are certain financial records that we also must have in order to complete the investigation. Even though they are voluminous and it will require a lot of work to sift through them, we are compelled to do that if we are going to complete our investigation.

The gentleman from Connecticut.

Mr. MORRISON. Thank you, Mr. Chairman.

I would like to say at the outset that I also commend E.F. Hutton for retaining Mr. Christopher. Certainly, if the spirit of cooperation goes on that has gone on with respect to my particular request at the last hearing, that has gone on within the last 48 hours, I think you will have done yourself a favor. I think it is much improved over what we felt at the first hearing.

At the first hearing, Mr. Fomon, you indicated that the understanding of what had gone on here was a problem that was known to people way down the chain, but not something that was controlled, or understood, or monitored by senior executives. Since that time, you have been—you were rather extensively quoted in the Wall Street Journal and the New York Times with quite a different view. To quote from the Wall Street Journal, you said:

> The Justice Department's description that only two middle-level management employees were involved seems incredible to me. I cannot believe the whole thing was orchestrated by such few middle-level managers.

Similar quotes were in the New York Times.

What is it that happened or that you received in terms of information or documents since the hearing on July 19 that gave rise to this differing view of what is going on here?

Mr. FOMON. Well, I cannot say that I saw any documents that gave rise to those new characterizations of what I said. From the beginning, I never believed that two $40,000 a year employees—which is the way the Justice Department characterized them—could have devised such a scheme. From that, the press seems to have implied that it had to be top management, if it was not two $40,000 a year employees.

You must understand that there is a huge range of employees between top management and two $40,000 people.

Mr. MORRISON. You said to the Times that, if you had it to do all over again, the company would not have taken full responsibility; you would have pleaded guilty on behalf of the company, and the individuals involved would have stood by themselves.

What is it that caused you to have that view? And, perhaps more importantly, what is it that you did not have before you when you made the earlier decision as to how to handle this case?

Mr. **Fomon.** There was nothing in the way of evidence that I have before me now that I did not have then.

Mr. **Morrison.** If I could interrupt there, did you have all of these memos from Mr. Ball at the time you made the decision that has recently come to light? Did you have the memos when you made the decision to plead guilty?

Mr. **Fomon.** No, I did not.

Mr. **Morrison.** Don't those memos raise questions in your mind about whether Mr. Ball had some knowledge here?

Mr. **Fomon.** See, I don't know what memos the Justice Department had.

Mr. **Morrison.** I am focusing on what you had. You ultimately made the decision as to how E.F. Hutton would respond to this indictment. Is that a correct understanding? It was your responsibility to make the recommendation?

Mr. **Fomon.** Yes; I made the recommendation. The entire board of directors was consulted on entering into the plea agreement. When the plea was entered, I thought that would end the matter. I had no comprehension that the case would become a major, public issue; that it would continue to divert us from our business. And that is what was behind my saying had I to do it all over again, perhaps I would have preferred going through trial and let those individuals who the Justice Department chose to indict stand on their own.

Mr. **Morrison.** Let me try to pin it down. There is a long, obviously—we are going to have further questions after we get all the documents and look at them. It is not my intention to turn this hearing into that exploration.

Mr. **Hughes.** I want to caution the gentleman, if I might, the hearing was structured to be a hearing to elicit documents and information.

Mr. **Morrison.** I understand that, Mr. Chairman.

Mr. **Hughes.** Even though the gentleman has, so far, I think, couched it in those terms, I just hope we stay that way.

Mr. **Morrison.** I will be cautious and try to be brief. I think my next two questions will close it out in that regard, Mr. Chairman.

My concern, Mr. Fomon—I have asked you the question whether you have—we got those five documents and the discussion of what was in Mr. Ball's office quite recently, between the first hearing and today. I take it you did not have access to that information when you made your decision about how to handle the case, as far as a criminal plea; is that right or wrong?

Mr. **Fomon.** That is true. I did not have that information. But, you know, I must remind you the reason I hired Judge Bell to do an investigation was to interpret these documents, to point out to me who was responsible for this program. I am not interested in his determining who was legally culpable. I am interested in finding out who was operating unethically within the firm. That is why I hired him. I would want him to interpret those new documents.

Mr. **Morrison.** Having found that cache of documents which raised some questions of culpability, are you confident you have structured the investigation at this point that, No. 1, any other such caches of documents will be discovered; and, No. 2, they will be turned over to this committee?

Mr. **Fomon**. Absolutely. They will be turned over to this committee, as well as the SEC, and the Justice Department, and the National Association of Securities Administrators.

Mr. **Morrison**. Mr. Chairman, I have other questions. I think my time has expired.

Mr. **Hughes**. The gentleman from Florida.

Mr. **Shaw**. Thank you, Mr. Chairman.

Recalling our last hearing, we were looking at overdraft situations which accountants were making—your certified public accountants were making internal adjustments in excess of $400 million. I would like—and like to suggest to the chairman—that we might ask these auditors to come forward. I would like to also have an opportunity to examine their work papers.

I am a little—I guess my main concern here is with these huge entries being—adjustment entries being made by your CPA's year after year, as to how this went undiscovered by top management. Perhaps there is something that we all can learn here.

I don't care how large your company is—a $400 million overdraft made consistently at the end of each year is a significant figure, and one which I believe should be covered, not only as a footnote to the financial statement but also should be reflected in the opinion that the CPA's are giving on the financial statements.

Do you have any problem or objection to our making a request from the certified public accountants that they produce their work papers with regard to these particular entries or other entries in their examination of your financial records?

Mr. **Fomon**. No; I have no objection.

Mr. **Shaw**. Mr. Chairman, I might suggest this is something this committee might be most interested in.

Mr. **Hughes**. The gentleman raises a very, I think, pertinent issue. So far, our efforts to get information have been frustrated by the exercise of the attorney-client privilege. I would hope that we can overcome that. We are going to ask your Mr. Rae, when he is before us, some questions about that. I think it is important for us to have access to CPA's.

Mr. **Fomon**. I think on the attorney-client privilege there has only been one instance. That related to the Arthur Young examination of our cash management practices. I invited you to pose the question to Warren Christopher, and no one ever posed the question to him.

Mr. **Hughes**. Well, we haven't finished the questioning yet. We are operating under the 5-minute rule. A lot of the questions members want to ask will be asked, I have a feeling.

I say to the gentleman, I think the gentleman is correct. I think that would be important for us at some future hearing to hear from the CPA's.

Mr. **Shaw**. Thank you, Mr. Chairman. That is the only question I have. I yield back.

Mr. **Hughes**. The gentleman from Kentucky.

Mr. **Mazzoli**. Thank you, Mr. Chairman.

Let me, Mr. Fomon, suggest that I am really surprised that you would be surprised that a plea of guilty to 2,000 counts of mail and wire fraud would not excite some curiosity, particularly in the effect that you are a fiduciary company. You are handling somebody else's money.

From what I gathered from our first hearing a few weeks ago, nobody lost money. In effect, you were dealing with the banks. You were getting money from the use of the float system. But I find that a little bit awkward for me to understand. I would ask you this question: Why would a person of your stature, working with a fiduciary company, be surprised that 2,000 counts of mail and wire fraud would not just sort of drop like a stone in the pond?

Mr. Fomon. Well, I never realized that this would result in an investigation of the Justice Department. Furthermore, you understand that there is no evidence that there were 2,000 counts or any particular number of counts. The Justice Department wanted to impose a fine of $2 million, and the only way they could get to a $2 million fine was to work the numbers backwards, because there was a maximum fine of $1,000 per count.

So, we said, OK, $2 million fine. You have to write it up as 2,000 separate counts, fine. There is no evidence of 2,000 counts.

Mr. Mazzoli. I am not here to defend the Justice Department, as you heard, because you sat here this morning. We will get back to this working backwards. I doubt that is simply the way this case was structured. I feel confident they had more to go on than just taking a fine which you all agreed to, and working the accounting to fit it.

My friend from Connecticut brought up the point a moment ago. I just wondered—or perhaps it was my friend from Florida. Would you, as the leader of your company, the CEO, in a time of stress and strain, would you be willing to order the waiver of any attorney/client relationship so that Arthur Young would be free immediately, starting tomorrow, to yield over the data?

Mr. Fomon. As I said, I do not understand the implications of that.

Mr. Mazzoli. I think you do, Mr. Fomon, please. You do understand what the attorney/client privilege is.

Mr. Fomon. I would not waive it except on——

Mr. Mazzoli. Why would you not waive it, if you really want to get to the heart of the matter? As you say, in your company, who was unethically acting within your company? Why would you not want to waive the attorney/client privilege?

Mr. Fomon. I am not a lawyer. I understand there are a lot of implications to waiving the attorney/client privilege downstream. After all, this case is settled.

Mr. Mazzoli. One implication, of course, is it makes it tougher for us to get to the people who were at fault, who may be higher placed, as my friend from Connecticut said.

Let me go back to the $40,000 a year explanation which I find not totally persuasive. You suggested earlier to a question by our distinguished chairman that somehow or the other a company as gigantic and as remarkably huge as E.F. Hutton had no organizational chart. So that, in effect, two organizational charts have been yielded up.

Yet, you said very confidently to my friend from Connecticut that there are many layers between the $40,000 a year people; that they are sort of like loose change compared to the upper management. Yet, you said that very confidently. To my friend you said there is no such thing as an organizational chart.

Somehow can you make that very strong statement that, you know, $40,000 people are just kind of lost along the way?

Mr. FOMON. E.F. Hutton & Co. operates as a large family. Everyone knows basically who is in charge of what. We never went to the—as far as I know no one ever drew it up in the form of a chart on a piece of paper. We supplied you, I believe, with internal telephone directories that lay out exactly who has what title.

Mr. MAZZOLI. Again, I apologize to you if I sound a little skeptical and there is a tone in my voice. I just cannot believe that. Like I said at the first hearing, my dear old father could have told you to the very penny how much it cost to put up tile in the bathroom. He knew the metal, lathe, concrete, labor cost. Yet somehow at times you say it could have happened in the board rooms, and on the other hand you said specifically you know, well, down into the suboffice because E.F. Hutton is a family. All family knows what everybody is doing.

It seems to me we get back then to this factor I brought up before—plausible deniability. It makes it easy to deny it because it is structured so it can be denied. On the one hand you have a chart. On the other hand you don't. I just think again with respect to you as a gentleman of leadership in your field that that is not a particularly persuasive answer.

Let me, Mr. Chairman, if I might, go on for one point and then get to the documents that we talked about earlier today.

You said today in your statement that you are anxiously awaiting Judge Bell's inquiry results in order that we can take corrective action in the company. It leads me to think that perhaps there is some undone business; that you don't really feel like you may have corrected it to the extent you can.

May I ask you, are there any letters that you have sent out to your people saying that no more of this exotic and imaginative cash management is permitted? Is that awaiting some kind of final wrap-up by Judge Bell?

Mr. FOMON. Well, from the standpoint of the illegal procedures being stopped, no, that is not awaiting any decision from Judge Bell, but you know——

Mr. MAZZOLI. What corrective action then? What were you talking about when you said corrective action?

Mr. FOMON. I am talking about to the extent that there were employees who designed this illegal system. They do not belong in E.F. Hutton and Co.

Mr. MAZZOLI. The only left undone business is ferreting out the people who did this check-kiting scheme and their firing and beheading or drawing and quartering, whatever is the proper penalty? Is that the only thing left?

Mr. FOMON. I think those same people, when their names are disclosed, are going to be subject to investigations by the SEC and the State.

Mr. MAZZOLI. As far as you are concerned, something like what was going on then can't go on now? There is no such thing as this kind of cash management, check kiting, that type of thing? Is that correct to your knowledge?

Mr. FOMON. That is correct.

Mr. MAZZOLI. Let me ask you one thing. One of the elements we talked about at the first meeting was this incredible scheme of consecutive numbers. Somehow it got mussed up and blurred on the checks. So you got more use of the float. I asked a question myself on page 180 of the transcript. It was a fairly long question which is my wont, I guess, to be a little verbose.

In any event, "could we have the name of the printer you dealt with?"

"Mr. FOMON. I would be glad to get you the numbers on how much business we do with this printer."

I am advised by staff that that has not been supplied.

Mr. FOMON. It was my understanding that that information had been supplied to the staff.

Mr. MAZZOLI. My understanding is it is not. I would ask you again would you be able to supply it by Monday or Tuesday or something like that?

Mr. FOMON. I will supply it by Monday.

[The information follows:]

O'MELVENY & MYERS

400 SOUTH HOPE STREET
LOS ANGELES, CALIFORNIA 90071-2899
TELEPHONE (213) 669-6000
TELEX 67-4122 · 4667796 (ITT)

1800 CENTURY PARK EAST
LOS ANGELES, CALIFORNIA 90067-1589
TELEPHONE (213) 553-6700
TELEX 67-4067

1800 M STREET, N. W.
WASHINGTON, D. C. 20036-5857
TELEPHONE (202) 457-5300
TELEX 89-622 (202) 833-3872 [illegible]

610 NEWPORT CENTER DRIVE
NEWPORT BEACH, CALIFORNIA 92660-6429
TELEPHONE (714) 760-9600 · (213) 669-6000
TELEX (714) 760-1387 [illegible] · 4722088 (ITT)

660 FIFTH AVENUE
NEW YORK, NEW YORK 10019
TELEPHONE (212) 247-4040
TELEX 127064

October
30th
1 9 8 5

OUR FILE NUMBER
408,100-27

WRITER'S DIRECT TELEPHONE
(202) 457-5901

Honorable William J. Hughes
Chairman
Subcommittee on Crime
Committee on the Judiciary
U.S. House of Representatives
341 Cannon House Office Building
Washington, D.C. 20515

Dear Chairman Hughes:

In response to the Committee's pending request for the amount of business that Hutton does with Northeast Forms, the printer referred to on page 44 of the July 1985 transcript and in the transcript of the June 1985 hearing at page 180, I am providing the figures below. This supplements the explanation of the issue of "misencoded checks" previously provided in response to questions asked at the June hearing.

Northeast Forms was one of 40 or so printers used by Hutton, several of which printed checks. I further understand that there were several other printers with whom Hutton did much more business than that which it does with Northeast Forms. The figures (rounded to the nearest 1,000) are as follows:

1979 (May - December available)	$ 450,000
1980	801,000
1981	890,000
1982	1,018,000
1983	1,210,000
1984	1,311,000
1985 (January - September)	706,000

For the years 1979-1981, I understand that less than 10 percent of these amounts represents the cost of printing checks. For 1981 to present, I understand that approximately 15 percent of these amounts represents the cost of printing checks.

Sincerely,

Zoe E. Baird
for O'MELVENY & MYERS

cc: Honorable Romano L. Mazzoli
Hayden W. Gregory, Esq.
Virginia Sloan, Esq.

Inter-Office Memorandum

EFHutton

TO Tom Morley

FROM Paul Hines

SUBJECT Testing of Checks

DATE June 20, 1985

Effective immediately, I want you to insure that all reorders or new orders of E.F. Hutton & Company Inc. checks be given to the bank prior to use for testing by the Purchasing Department and we must receive from the bank positive confirmation that it passed the test before issuing to the branches.

cc: M. Castellano
T. Lillis
J. Moorhead
M. Catalano

Paul Hines

FC 14A (Rev. 11/80)

Bank of America

Christopher T. Mahoney
Vice President

North America Division
New York Office

May 31, 1985

Mr. Thomas P. Lynch
President
E.F. Hutton Group, Inc.
One Battery Park Plaza
New York, NY 10004

Dear Tom:

At our meeting On May 9th, Bruce Mitchell outlined a number of changes in our bank's approach to depository services which we are implementing at this time. Bruce indicated that we would be following up with details on these changes, which are provided below.

At the outset, I would like to reiterate Bruce's assurance that we value our operating relationship with E.F. Hutton and our objective is to continue to provide you with excellent depository services at a fair price. We believe that the changes described below are both fair and logical.

1. Collected Balance Positions

We will no longer analyze collected balances on a month-average basis. Instead, we will accrue interest on daily uncollected positions at our average monthly posted broker rate, and will credit interest on collected positions at our earnings allowance rate. These will be netted and the amount due the bank (if any) will be payable monthly. Positive accruals will not be carried. This policy will be effective beginning June 1, 1985.

For the period January-April of this year, we have compiled the attached calculation of your balance positions on a month-average basis, which indicates a deficiency over this period (Attachment I). We have billed this at our average monthly posted broker rate. We will do the same for May when we receive the account analysis.

2. Float

   Although float is a by-product of certain depository activities, it is also expensive for us, since it is a sterile use of our balance sheet and thus incurs a capital usage cost. There should be a relationship between depository activity and the resulting float; we view float above this amount as excessive and we will charge back the cost of this float to the customer. In the case of E.F. Hutton, we have set $10 million as the level above which we will charge for float. For the time being, this charge will be assessed on a month average basis at .10% p.a., although this charge may be adjusted upwards in the future since the bank has not yet rendered a final decision on this issue. This policy will also be effective beginning June 1, 1985.

   Although we will be charging for float, the above price of .10% does not fully recover the full opportunity cost to us of float, which is higher. Therefore, we also request that you terminate unnecessary float-creating practices, such as funding your accounts with large items drawn on your New York accounts, and other such float-creating activity which does not represent the concentration of customer funds.

3. Direct Debit

   Effective immediately, we will collect all loan and depository fees and interest via direct debit, with itemized prenotification by mail.

4. Check Quality Issues

   The quality of your checks has been a recurring problem since the 1970's. These problems have caused costly processing difficulties at our check clearing and deposit reconcilement departments due to the very high level of rejected items and the resulting reconcilement problems, both due to the unreadability of your items. These problems have been brought to your attention a number of times in the past. We are still in the process of compiling a bill for the incremental expense incurred by our Data Processing and Account Reconcilement departments since 1982 due to the manual tasks resulting from the unusually high level of non-reads. Also, as I indicated to Tom Morley, we will no longer be able to credit your account for non-reads pending research.

   The solution to these problems is a speedy improvement in check quality. We would like to see these problems (as measured by our reject rate) resolved by August 31, 1985. By that time, we would expect you to be using checks which meet our specifications and which have a reject rate of not more than .5% on the first passes on the reader/sorter during clearing, and a reject rate of not more than 4% during sequencing for reconcilement. Our check people have been in contact with your vendor since our meeting, and have made some progress. (See Attachment II.) We would also like to receive samples of your new checks for testing, and we would also like to receive samples of subsequent batches as they are produced. In this way, we will save each other considerable trouble and unnecessary expense.

5. Account Migration

We would like to proceed to replace your 37-odd branch accounts with a single concentration account into which all Hutton locations will deposit. This account will be on deposit reconcilement with monthly cumulative reports. We will provide your branches with deposit tickets with their addresses and accounting numbers printed in the upper left-hand corner, which will also be MICR-encoded by location in order to have their daily (ledger) deposit data picked up on Bamtrac detail reporting. A separate account will be set up for returned items which will ZBA from the concentration account. We will be able to provide your Los Angeles office with photocopies of returned items daily by rapifax, which will show the branch location on the endorsement stamp. The checks themselves will be sent to your L.A. office by mail.

We are ready to proceed with this immediately. We believe that this new configuration will be cheaper for you, and will also result in better service, since all of your depository activity will be at the Corporate Service Center. We are committed to managing this transition smoothly, and with as little disruption to your operations as possible.

Later this year, we plan to consolidate our Corporate Service Centers in San Francisco (North) and Covina (South) into one centralized unit located in Concord (near San Francisco). This change should be transparent to you; your account numbers will not change. For this reason, we wish to move your branch accounts to our Northern Service Center now, in order anticipate this consolidation. These accounts will remain under the control of the Hutton account administrator in Covina, pending the consolidation which will occur later in the year.

Tom, I hope that these changes as outlined above will work to our mutual benefit. Our bank remains committed to providing superior services to major depository customers such as E.F. Hutton.

Sincerely,

Christopher T. Mahon

CTM/sg
Atts.

cc: Tom Morley, SVP
E.F. Hutton & Co.

ATTACHMENT I

E.F. Hutton 1985 Account Balances

	Ledger	Float	Collected	(+) EAR	(-) Interest
January	66,067,646	64,900,040	1,167,605	8,072.15*	
February	48,293,877	60,826,594	(12,532,717)		92,602.85
March	56,586,022	65,351,874	(8,765,853)		72,313.42
April	62,829,676	48,154,437	14,675,239	89,691.84*	
				97,763.99	164,916.27

Total Amount Due: $67,152.28

EAR (Earnings Allowance Rate) is based on the average daily bond equivalent yield of 90-day treasury bills for the preceding 3 mos. rounded up 1/4%.
1/85 - 9.25%
4/85 - 8.45%

Interest - Broker's Prime Weighted Average
2/85 - 9.5 %
3/85 - 9.58%

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* Figures adjusted for reserves

Bank of America
P. O. Box 37000
San Francisco, CA 94137

May 22, 1985

Mr. Joseph Di Donato
Northeast Forms, Inc.
47 West Street
New York, NY 10006

Dear Mr. Di Donato:

On April 25, 1985, I spoke with you regarding the problems with E.F. Hutton's checks drawn on account numbers 12358-00088 and 12351-00213.

As I stated, the problems are as follows:

1. Large voids and spotting within the characters.
2. Ink on the checks is lifting off.
3. On-Us symbol has a halo around the right symbol only.
4. Sequential numbering on occasion is printed crooked.

In addition, the following questions were asked. And you stated that you would let me know what steps are being taken to improve your quality.

1. What quality control measures are being taken prior to each run, such as equipment or gages?
2. What type of equipment are they printed on and how often is the equipment maintained or adjusted? Daily, weekly?
3. What type of ribbon is purchased?
4. Do you test each shipment of ribbons prior to use?
5. Where are the ribbons stored? Excessive hot or cold areas?
6. Are the checks printed on 60lb offset or 24lb MICR bond?
7. Which way is the grain going?

Joe, should you need additional information regarding gages or MICR manuals, please give me a call at (415) 622-7166.

Bank of America
P. O. Box 37000
San Francisco, CA 94137

Page #2

Enclosed is my business card.

Sincerely,

Karen de Klerk
Assistant Vice President
Customer CHeck Support
Services #3075
(415) 622-7166

cc: T. Sherman
T. Morley
J. Still

encl.

Bank of America
P. O. Box 37000
San Francisco, CA 94137

June 07, 1985

Mr. Thomas Sherman
E. F. Hutton
1 Broadway Way
New York, NY 10004

Dear Tom:

Enclosed is a copy of the letter to Northeast Forms, Inc., stating that their samples are exceptable. However, I would like to establish a procedure through you to continue to receive samples on a regular basis.

Please let me know what arrangements would be best for you.

Sincerely,

Karen de Klerk
Assistant Vice President
Customer Check Support
Services #3075
(415) 622-7166

Enclosure.

Bank of America
P. O. Box 37000
San Francisco, CA 94137

June 07, 1985

Mr. Joseph Di Donato
Northeast Forms, Inc.
47 West Street
New York, NY 10006

Dear Mr. Di Donato:

Per our conversation, enclosed is the results for account numbers 12358-00088 and 12351-00213.

In both cases they are exceptable. However, in the future we would like to receive samples periodically to ensure the best possible quality.

Thank you for the samples and we look forward to receving additional ones in the future.

Sincerely.

Karen de Klerk
Assistant Vice President
Customer CHeck Support
Services #3075
(415) 622-7166

cc: T. Sherman
J. Still

Enclosure.

Magnetic Ink Encoding Evaluation

BRANCH/PRINTER EF HUTTON

WORK OF 06-04-85 STYLE A/C 12351-00213

EVALUATED BY Rustom Swaleh

CONCURRENCE Marie Grant

/: RUNS

CUSTOMER CHECK SUPPORT SERVICES #3075

BATCH NO. 5337

DATE 06-06-85 19

ITEMS RECEIVED 1000, (*Visually. 200 at random)

ITEMS EVALUATED 1000, (*Visually 200 at random)

COMPUTER REJECTS None

ITEMS OF NON-COMPLIANCE 13

xx☒ ACCEPTED ☐ REJECTED

A numeric sampling of the above checks has been evaluated to determine compliance with the American Bankers Association Specifications (147 R 3, THE COMMON MACHINE LANGUAGE FOR MECHANIZED CHECK HANDLING AND THE SUPPLEMENT TO 147 R 3).

The number of recurring casualties on the non-compliance items are listed below. The remarks column indicates any areas of trouble, whatever, and is reported both in the case of unacceptable and marginal work.

This report refers only to the batch of checks described above and does not constitute an endorsement by the Bank of America of this printing concern and its ability to print magnetically encoded checks.

SPECIFICATIONS		*RECURRENCE OF NON-COMPLIANCE	REMARKS
PAPER WEIGHT	24lb. MICR BOND or EQUIVILANT		
FORMAT (CODING LOCATION)	± 1 16 INCHES		
SPACING	.125 – .010 INCHES		
CHARACTER SKEW	± 1½ DEGREES		
ALIGNMENT OF ADJACENT CHAR.	.007 INCHES		
EMBOSSMENT	.001 INCHES		
SIGNAL LEVEL	50 – 200%		
CHARACTER DIMENSIONS	± .0015 IN. FROM NOMINAL EDGE (MIN. HORIZ. BARS .011 IN.)		
UNIFORM INK	AVERAGE EDGE EDGE SQUEEZE OUT NO MORE THAN .0015 IN		
CHARACTER EDGE IRREGULARITY	25% OF EDGE UP TO .002 IN BEYOND AV. TOLERANCE		
VOIDS	.008 IN. x .008 IN. ANYWHERE IN CHAR. ZONE .010 x .010 IN. WITHIN MULTIPLES SEGMENTS LONG THIN VOIDS .002 WIDE TOTAL VOIDS IN COLUMN OR ROW 20%	* 11	(5) Broken character in all three fields. (3) Broken symbol in all three fi (3) Insufficent ink in Transit R -ing & ON-US field.
EXTRANEOUS INK – FRONT	ONE .004 x .004 SPOTS PER CHAR ZONE BUT MAX. OF 5 PER FIELD	* 2	Ink smear in AUX-ON-US & TRANSIT ROUTING fields.
EXTRANEOUS INK – BACK	UP TO .006 x .006 OF EQUIVALENT SPOTS		

NOTE: PLEASE VOID ALL CHECKS BEFORE FORWARDING FOR EVALUATION.

WTN 10

Magnetic Ink Encoding Evaluation

BRANCH/PRINTER EF HUTTON
WORK OF 05-22-85 STYLE A/C 12358-00088
EVALUATED BY Rustom Swaleh
CONCURRENCE Marie Grant

BATCH NO. 8558
DATE 06-11-85 19
ITEMS RECEIVED 230 Visually 60 at random
ITEMS EVALUATED 230 Visually 60 at random
COMPUTER REJECTS None
ITEMS OF NON-COMPLIANCE 1

CUSTOMER CHECK SUPPORT SERVICES #3075

xxxx☒ ACCEPTED ☐ REJECTED

A numeric sampling of the above checks has been evaluated to determine compliance with the American Bankers Association Specifications. (147 R 3, THE COMMON MACHINE LANGUAGE FOR MECHANIZED CHECK HANDLING AND THE SUPPLEMENT TO 147 R 3).

The number of recurring casualties on the non-compliance items are listed below. The remarks column indicates any areas of trouble, whatso ever, and is reported both in the case of unacceptable and marginal work.

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FORMAT (CODING LOCATION)	±1 16 INCHES		
SPACING	.125 – .010 INCHES		
CHARACTER SKEW	±1½ DEGREES		
ALIGNMENT OF ADJACENT CHAR.	.007 INCHES		
EMBOSSMENT	.001 INCHES		
SIGNAL LEVEL	50 – 200%		
CHARACTER DIMENSIONS	±.0015 IN. FROM NOMINAL EDGE (MIN. HORIZ. BARS .011 IN.)		
UNIFORM INK	AVERAGE EDGE EDGE SQUEEZE OUT NO MORE THAN .0015 IN.		
CHARACTER EDGE IRREGULARITY	25% OF EDGE UP TO .002 IN. BEYOND AV. TOLERANCE		
VOIDS	.008 IN. x .008 IN. ANYWHERE IN CHAR. ZONE .010 x .010 IN. WITHIN MULTIPLES SEGMENTS LONG THIN VOIDS .002 WIDE TOTAL VOIDS IN COLUMN OR ROW 20%	1	Broken character in ON-US-field.
EXTRANEOUS INK – FRONT	ONE .004 x .004 SPOTS PER CHAR. ZONE BUT MAX. OF 5 PER FIELD.		
EXTRANEOUS INK – BACK	UP TO .006 x .006 OR EQUIVALENT SPOTS		

NOTE: PLEASE VOID ALL CHECKS BEFORE FORWARDING FOR EVALUATION.

3075 10

EFHutton
INTER-OFFICE MEMORANDUM

TO Mike Catalano

FROM Thomas P. Morley

DATE May 16, 1985

SUBJECT BOA Check Quality

As you may be aware, Bank of America has been advising us of an ongoing problem concerning quality control problems with our BOA checks printed by NorthEast Business Forms.

On April 25, Tom Sherman, Hugh van Hengel and myself met with two Bank of America loan officers, at which point a conference call with Karen DeKlerk, of BOA's Customer Check Support group, was made. According to Ms. De Klerk, basically because of various quality problems with the MICR line of our checks, we have a check reject rate far in excess of industry standards. Because of this high reject rate, our account has required special handling by BOA, equating to approximately $950.00 a month in added labor costs. Tom Sherman then briefly discussed the problem with NorthEast Business Forms and asked them to expect a call from Ms. DeKlerk to try working with them in resolving the problem.

Subsequently, last week this situation was again discussed at a meeting with BOA, Tom Lynch and myself. Apparently, this problem has yet to be resolved, and BOA can not understand why our level of rejects can not be reduced to the industry standard. I am at a loss to explain it as well, and at this point it is damaging our overall relationship.

I would appreciate it if at this point, you could look into the problem and shepherd it to a satisfactory resolution. We face both permanent damage to our relationship, as well as the $950.00 per month special handling charge.

If I can be of any assistance in this process feel free to contact me. Though let me stress that we should move as rapidly as possible in solving this problem, even if it means changing our current printer.

Please keep me informed.

Tom

cc: Hugh van Hengel
Thomas Sherman

MEMORANDUM June 20, 1984

Re: "Misencoded" Checks

Prior to late 1981 Hutton maintained its principal branch reimbursement account at Chemical Bank. Checks for this account were preprinted "Pay to the order of E. F. Hutton & Company Inc." and sent to all the branches for use in avoiding negative bank ledger balances. A Hutton branch would deposit a Chemical check in its branch bank to reimburse itself, the check would clear through the banking system and be presented to Chemical, and the Company would fund payment of each day's clearings by wire transfer. The Company ordered several thousand of these checks from the printer at a time, divided them into small batches, and sent them out to branches as needed.

The Company's chief check printer is Northeast Forms, Inc. Northeast prints stock checks for the Company in batches of 100,000 and holds them until the Company orders smaller batches (usually between 1,000 and 10,000) for its branches. To order checks the Company's purchasing department sends the printer a "Z-Release" form, which authorizes him to release a certain number of checks from stock (Exhibit 1). This release specifies the form number of the checks being ordered, the address to be printed on the checks, and the check numbers to be printed in Arabic numerals on the upper right of the check. If special instructions accompany the order, the statement "See attached specification sheet" will appear on the Z-release. The specification sheets include a "Specifications for Printing Checks" form, which sets forth the bank name and address, the transit and routing code, and the microencoding instructions (Exhibit 2). This is attached to a "Specifications for Printing Forms" sheet that designates the form number of the checks, the quantity, the check numbers, and the priority of the order (Exhibit 3).

The coding that was missing from some checks should have appeared at the bottom of each check on the "MICR" (magnetic ink character recognition) or microencoded line. The MICR line of all of Hutton's checks contained the account number and a routing code for clearing. What was missing from some batches of checks was the sequential check number (i.e., check numbers 1, 2, 3, etc.) on the MICR line, although the sequential check numbers were printed in Arabic numerals in the upper right-hand corner of all checks.*

It is perhaps misleading to describe the checks at issue as "misencoded", since they were properly (albeit incompletely) encoded. The sole function of placing check numbers on the MICR line was to enable the bank to provide a monthly statement to the Company listing the checks that had cleared in numerical order. This service, called "Account Reconciliation Process" or "ARP", requires that a sorting machine read the MICR line.

---

* See Exhibit 4 for an example of a check with a microencoded sequence number. Note that "06933" appears at the extreme left of the MICR line.

Apparently, when checks without microencoded sequence numbers were presented to Chemical, they were rejected by the ARP system and had to be manually debited from the account, resulting in a one-day delay in debiting. Hutton would therefore be credited with an extra day's collected balances in the amount of the late-posted checks, even though Chemical had already paid the checks to the presenting bank. That this occurred at all is somewhat puzzling, since one would not think that the lack of a microencoded sequence number on a check would prevent the bank's computer from immediately debiting the proper account. The account numbers were correctly microencoded, and account debiting is obviously a more pressing concern to the bank than providing a customer with an account reconciliation. The Company believes, therefore, that this matter was primarily an operations problem at Chemical.

In any event, the lack of complete microencoding on the checks for this account was not willful, albeit it did drag on through a series of errors. When the account was opened in

1979, Hutton ordered 5,000 checks (numbered 1 to 5000) from its printer (Exhibit 5). The October 5, 1979 specification sheet (Exhibit 2) did not originally specify consecutive coding.

The Specification for Printing Forms sheet, which was sent to the printer along with Z Release # 14349 (Exhibit 6), requested that the printer send 50 samples to Hutton to be forwarded to Chemical for testing. The Company believes this was not done.

It is not clear precisely when Chemical requested the consecutive coding for this account, but on February 7, 1980 the October 5, 1979 specification sheet was revised and "X000000X" was written in heavy marker in the "Consecutive Number" box. This sheet also reads, in heavy marker, "Per Chem Bank -- MICR Consec # Required, Revised 2/7/80" (Exhibit 2). Since this order was for checks numbered 2,000 to 7,000, checks numbered 2,000 to 5,000 from the first batch were probably never used. This specification sheet was sent to the printer along with Z Release # 16102 and a Specifications for Printing Forms sheet that requested "MICR Consecutive Numbering" (Exhibit 7). The second order arrived fully microencoded, and the checks were distributed to the branches as necessary.

Eventually the supply of checks ran low, and another order was placed on April 12, 1981. The Z Release order

22751 (Exhibit 8) did not have a specification sheet attached and does not on its face refer to such an attachment, probably because this was merely a reorder that did not require any new specifications to be sent. MICR information does not appear on the Z-Release, so it would quite literally have been impossible for the printer to print the checks without referring to the prior specification sheet -- otherwise the entire microencoded line would be missing. The printer, in referring to that prior specification form, apparently overlooked the consecutive number coding requirement, because the MICR sequence coding on this batch of checks (numbered 7,001 to 13,000) was omitted. As this third order required the printer to reproduce checks with the same specifications as the second order, and as the second order had properly included microencoded consecutive numbering instructions (which, indeed, had been followed), it seems clear that the party responsible for the coding failure was the printer.

When Chemical told Hutton in June 1981 that uncoded checks were hitting the account, a new check order was placed, now for checks numbered 13,001 to 18,000. The Company again specified that consecutive numbering was to appear on the MICR line, and it also sent the bank's specification sheet to the printer to indicate where the numbers were to be placed (Exhibit 9). When these checks were delivered to the Company, however, the clerk who signed for them did not check them against the specification, and they were sent to the branches as received. No one noticed that the printer had not only omitted consecutive numbering on the MICR line but had also failed to print "E. F. Hutton & Company Inc." on the checks as he was supposed to do.

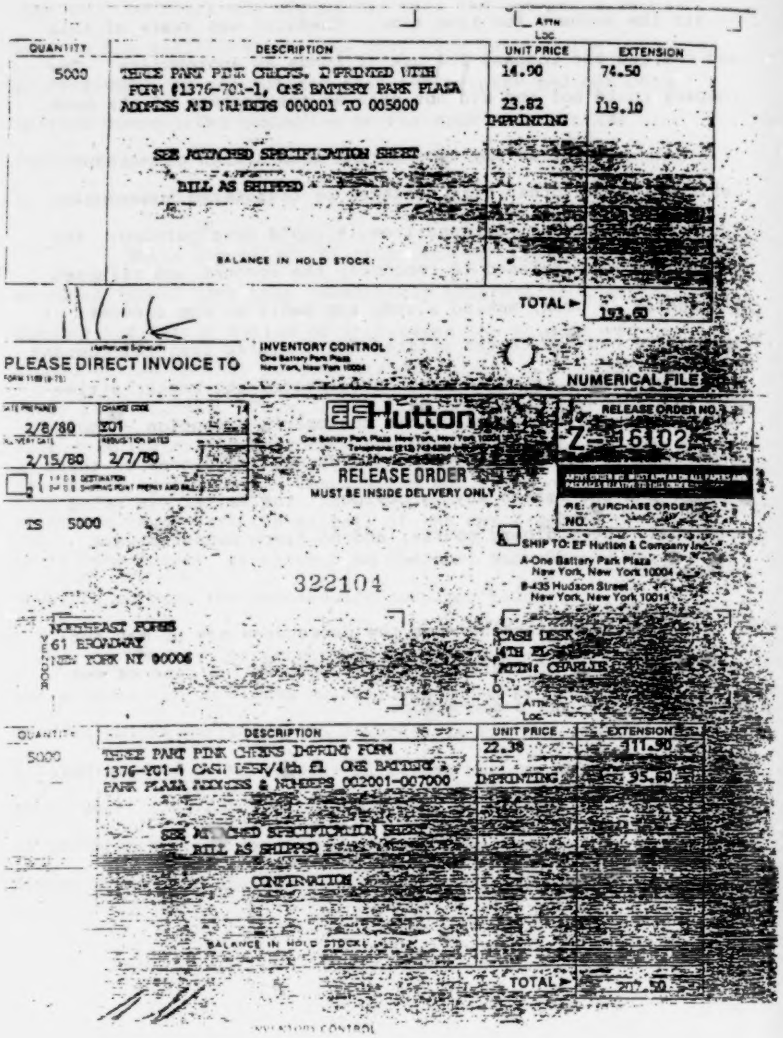
While any effect of this lack of consecutive micro-encoding should have been immediately apparent to Chemical, the Company had little notice of it because the account was not included on the monthly account analyses until late summer or early fall of 1981. Thus, apart from one telephone call in June -- which raised a problem the Company thought it solved by reordering checks -- the Company was not aware of the continued existence (much less the extent) of the check coding problem until late August, at which time Chemical backcharged the account to correct the erroneously computed balances.

Shortly thereafter the Company determined to close the account for unrelated operational reasons. The matter of uncoded checks was therefore regarded as solved, and the possibility of yet another reorder of checks was not considered. It took longer than anticipated, however, to effect the transfer of the branch reimbursement functions from Chemical to United States Trust Co., and non-sequentially-coded checks continued to hit the account for some time. Chemical was aware of this and charged the Company for use of funds as appropriate. The Company could not and did not gain at the expense of the bank.

Indeed, at any time during this series of mishaps (which might in other circumstances be considered humorous), Chemical had several alternatives it could have pursued: the bank could have refused to reconcile the account and returned the checks in bulk, making a lump sum debit to the account; it could have had new checks printed and insisted that the Company distribute them; it could even have invoked the banker's time-honored devices for catching his customer's attention -- bouncing checks or closing the account. Chemical did none of these things, and the reason why is obvious: the matter was being handled in the ordinary course, and no stern measures were called for.

Notwithstanding what the prosecutor may or may not have told a Bank of America official, no willful conduct was involved. This was a non-event.

E. F. Hutton & Company Inc.



Attn
Loc.

QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
5000	THREE PART PINK CHECKS. IMPRINTED WITH FORM #1376-701-1, ONE BATTERY PARK PLAZA ADDRESS AND NUMBERS 000001 TO 005000	14.90	74.50
		23.82 IMPRINTING	119.10
	SEE ATTACHED SPECIFICATION SHEET		
	BILL AS SHIPPED		
	BALANCE IN HOLD STOCK:		
		TOTAL ►	193.60

Authorized Signature

PLEASE DIRECT INVOICE TO

INVENTORY CONTROL
One Battery Park Plaza
New York, New York 10004

FORM 1169 (8-73)

NUMERICAL FILE

DATE PREPARED 2/8/80	CHARGE CODE Y01
DELIVERY DATE 2/15/80	REQUISITION DATED 2/7/80

☐ 1 F.O.B. DESTINATION
2 F.O.B. SHIPPING POINT PREPAY AND BILL

EF Hutton
One Battery Park Plaza New York, New York 10004
Telephone (212) 742-

RELEASE ORDER
MUST BE INSIDE DELIVERY ONLY

RELEASE ORDER NO.
Z-16102

ABOVE ORDER NO. MUST APPEAR ON ALL PAPERS AND PACKAGES RELATIVE TO THIS ORDER

RE: PURCHASE ORDER NO.

TS 5000

322104

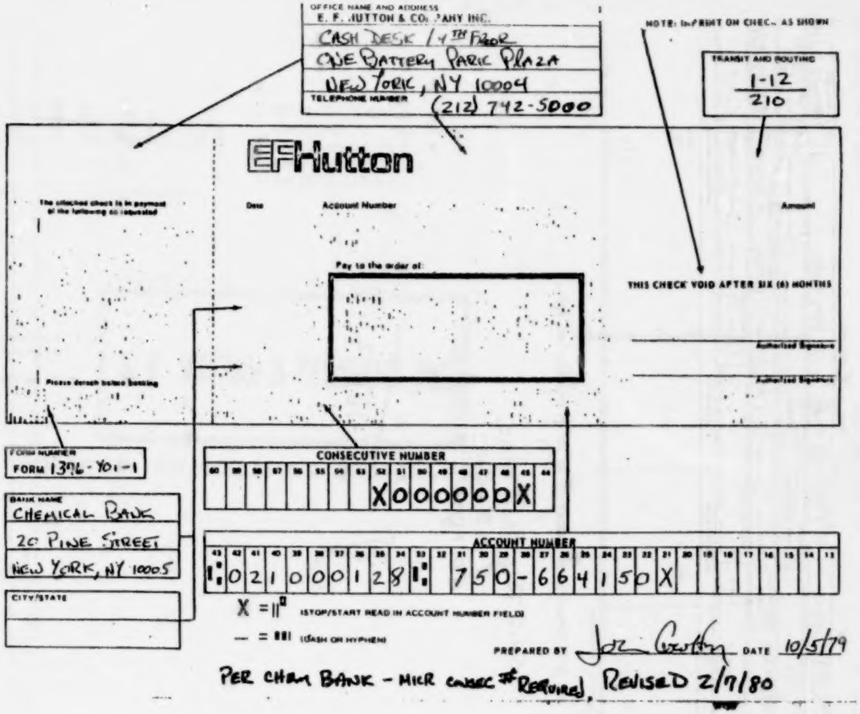
VENDOR
NORTHEAST FORMS
61 BROADWAY
NEW YORK NY 00006

☒ SHIP TO: EF Hutton & Company Inc.
A-One Battery Park Plaza
New York, New York 10004
B-435 Hudson Street
New York, New York 10014

TO
CASH DESK
4TH FL
ATTN: CHARLIE
Attn
Loc.

QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
5000	THREE PART PINK CHECKS IMPRINT FORM 1376-Y01-1 CASH DESK/4th Fl ONE BATTERY PARK PLAZA ADDRESS & NUMBERS 002001-007000	22.38	111.90
		IMPRINTING	95.60
	SEE ATTACHED SPECIFICATION SHEET		
	BILL AS SHIPPED		
	CONFIRMATION		
	BALANCE IN HOLD STOCK:		
		TOTAL ►	207.50

INVENTORY CONTROL



OFFICE NAME AND ADDRESS
E. F. HUTTON & COMPANY INC.
CASH DESK / 4TH FLOOR
ONE BATTERY PARK PLAZA
NEW YORK, NY 10004
TELEPHONE NUMBER (212) 742-5000

NOTE: IMPRINT ON CHECK AS SHOWN

TRANSIT AND ROUTING
$\frac{1-12}{210}$

EFHutton

The attached check is in payment of the following as requested

Please detach before banking

Date

Account Number

Pay to the order of:

Amount

THIS CHECK VOID AFTER SIX (6) MONTHS

Authorized Signature

Authorized Signature

FORM NUMBER
FORM 1376-Y01-1

BANK NAME
CHEMICAL BANK
20 PINE STREET
NEW YORK, NY 10005

CITY/STATE

CONSECUTIVE NUMBER

60	59	58	57	56	55	54	53	52	51	50	49	48	47	46	45	44
								X	0	0	0	0	0	0	X	

ACCOUNT NUMBER

43	42	41	40	39	38	37	36	35	34	33	32	31	30	29	28	27	26	25	24	23	22	21	20	19	18	17	16	15	14	13
⑆	0	2	1	0	0	0	1	2	8	⑆		7	5	0	-	6	6	4	1	5	0	X								

X = ⑈ (STOP/START READ IN ACCOUNT NUMBER FIELD)

— = ⑉ (DASH OR HYPHEN)

PREPARED BY DATE 10/5/79

PER CHEM BANK - MICR CONSEC # REQUIRED, REVISED 2/7/80

SYSTEMS & PROCEDURES DEP

☐ NEW FORM ☒ REVISION

FORM NUMBER: Form 1376-Y01-1
FORM TITLE: 3 Part Pink Check 2 (NY Cash Desk)
DATE PREPARED: February 7,1980

QUANTITY: 5,000
PRIORITY: ☒ RUSH NEED ASAP ☐ NEED BY ____________ ☐ NORMAL DELIVERY
ROUGH COPY ATTACHED: ☒ YES ☐ NO

NUMBER OF PARTS: 3
TYPE OF FORM: ☒ CHECK ☐ CONTINUOUS ☐ FLATNED ☐ PADDED ☐ SNAP OUT
CONSECUTIVELY NUMBERED: 002000 TO 007000
☒ M.I.C.R. SPECIFICA SHEET ATTACHED

PUNCHING: DIAMETER C TO C
OVER ALL SIZE:
HOW PREPARED: ☐ PEN ☒ TYPEWRITER ☐ HIGH SPEED PRINTER ☐ OTHER

PART	WEIGHT	COLOR OF PAPER	COLOR OF INK	MARGINAL WORDING

ADDITIONAL INFORMATION

Add MICR Consecutive Numbering as shown on attached spec.

SHIP TO: CASH DESK
4th Floor
ATTN C. ANZALONE

Z-16102

209384

NOTE: SEND 10 COPIES OF THE PRINTED FORM TO SYSTEMS & PROCEDURES – FAILURE TO DO SO WILL BE A CONSIDERATION WHEN REORDERING THE FORMS

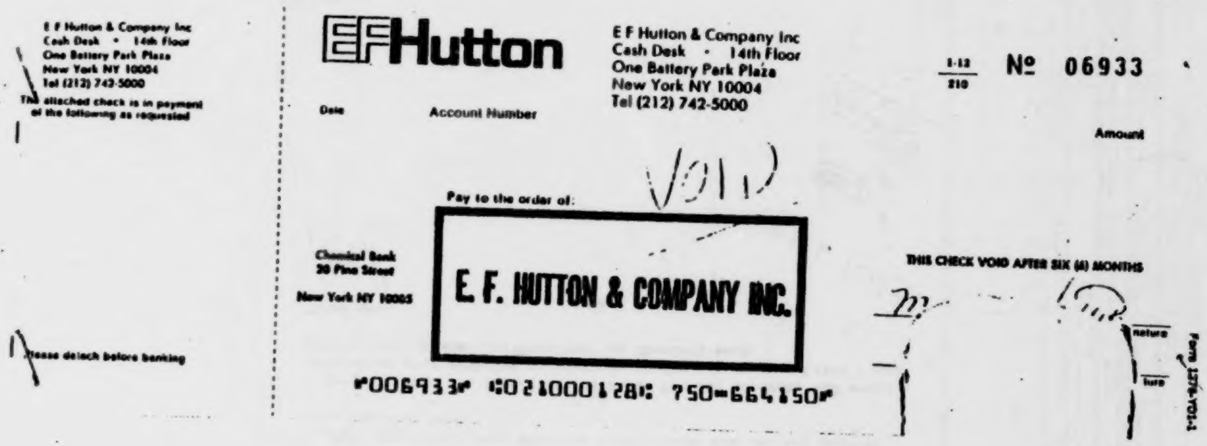
PROOFS REQUESTED ☐

PROOFS REQUESTED DATED

OK OK WITH CORRECTIONS NEW PROOF

INITIALS

APPROVED BY



E F Hutton & Company Inc
Cash Desk • 14th Floor
One Battery Park Plaza
New York NY 10004
Tel (212) 742-5000

This attached check is in payment of the following as requested

Please detach before banking

EF Hutton

E F Hutton & Company Inc
Cash Desk • 14th Floor
One Battery Park Plaza
New York NY 10004
Tel (212) 742-5000

1-12
210

№ 06933

Date

Account Number

Amount

VOID

Pay to the order of:

Chemical Bank
20 Pine Street
New York NY 10005

E. F. HUTTON & COMPANY INC.

THIS CHECK VOID AFTER SIX (6) MONTHS

nature

ture

Form 1376-YD1-1

⑈006933⑈ ⑆021000128⑆ 750⑉664150⑈

EFHutton
INTER-OFFICE MEMORANDUM

TO John Cowhey

FROM William Sullivan

DATE October 4, 1979

SUBJECT Branch Disbursement Account for Chemical Bank

I would appreciate your ordering 5,000 checks for our new account with Chemical Bank.

I have attached the specification sheet for our account, and would appreciate your advising me when the checks are ready so that I may send 50 such checks for "testing" at Chemical Bank.

Thank you,

Bill

1376 Y01-1

FC 14A (REV. 9/78)

SYSTEMS & PROCEDURES DEP

☒ NEW FORM ☐ REVISION

FORM NUMBER: FORM 1376-Y01-1

FORM TITLE: 3 PART PINK CHECK (NY CASH DESK)

DATE PREPARED: OCT. 5, 1979

QUANTITY: 5000

PRIORITY: ☒ RUSH NEED ASAP ☐ NEED BY____________ ☐ NORMAL DELIVERY

ROUGH COPY ATTACHED: ☒ YES ☐ NO

NUMBER OF PARTS: 3

TYPE OF FORM: ☒ CHECK ☐ CONTINUOUS ☐ FLATBED ☐ PADDED ☐ SNAP OUT

CONSECUTIVELY NUMBERED: 000001 TO 005000

☒ M.I.C.R. SPECIFICAT SHEET ATTACHED

PUNCHING: "DIAMETER "C TO C

OVER ALL SIZE:

HOW PREPARED: ☐ PEN ☐ TYPEWRITER ☐ HIGH SPEED PRINTER ☐ OTHER

PART	WEIGHT	COLOR OF PAPER	COLOR OF INK	MARGINAL WORDING

ADDITIONAL INFORMATION

SHIP 50 SAMPLES TO: W. Sullivan
4th Floor
One Battery Park Plaza

SHIP BALANCE TO: Cash Desk
4th Floor
One Battery Park Plaza

OCT 9

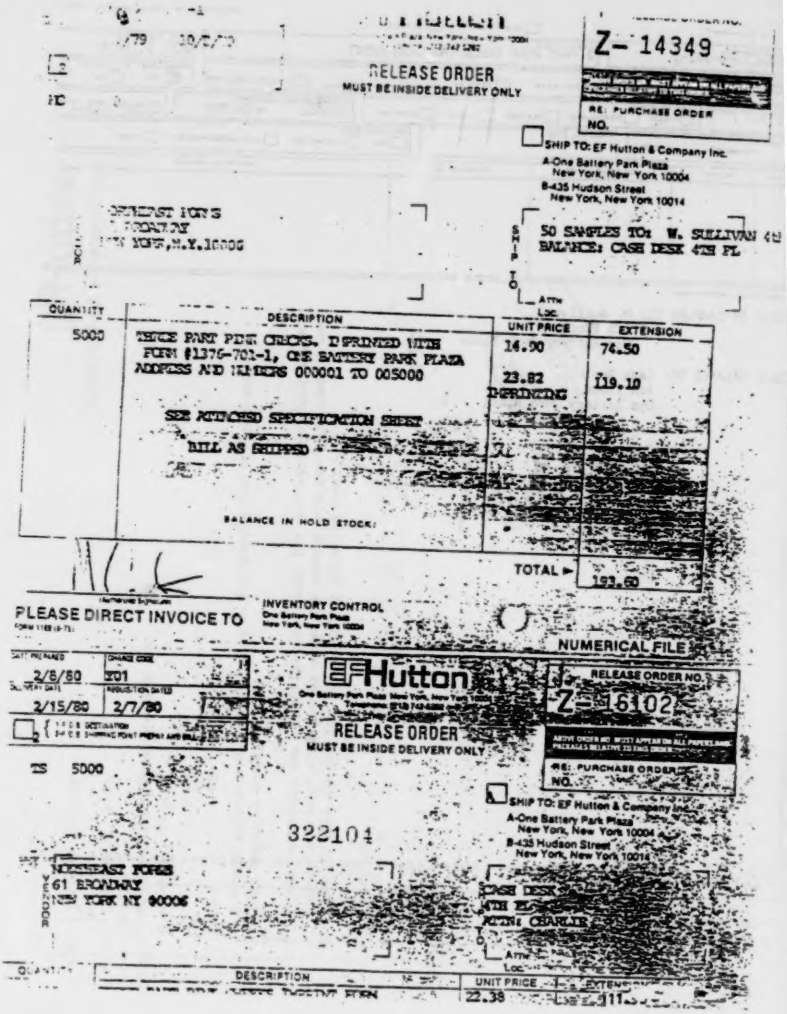
Z 14349

209376

NOTE: SEND 10 COPIES OF THE PRINTED FORM TO SYSTEMS & PROCEDURES – FAILURE TO DO SO WILL BE A CONSIDERATION WHEN REORDERING THE FORMS

PROOFS REQUESTED ☐

Tom Carter



/79 10/[illegible]/79

RC

RELEASE ORDER
MUST BE INSIDE DELIVERY ONLY

Z- 14349

RE: PURCHASE ORDER
NO.

☐ SHIP TO: EF Hutton & Company Inc.
A-One Battery Park Plaza
New York, New York 10004
B-435 Hudson Street
New York, New York 10014

NORTHEAST FORMS
BROADWAY
NEW YORK, N.Y.10006

SHIP TO
50 SAMPLES TO: W. SULLIVAN 4
BALANCE: CASH DESK 4TH FL
Attn
Loc.

QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
5000	THREE PART PINK CHECKS. IMPRINTED WITH FORM #1376-701-1, ONE BATTERY PARK PLAZA ADDRESS AND NUMBERS 000001 TO 005000	14.90	74.50
		23.82 IMPRINTING	119.10
	SEE ATTACHED SPECIFICATION SHEET		
	BILL AS SHIPPED		
	BALANCE IN HOLD STOCK:		
		TOTAL ►	193.60

Authorized Signature

PLEASE DIRECT INVOICE TO
FORM 1169 (6-75)

INVENTORY CONTROL
One Battery Park Plaza
New York, New York 10004

NUMERICAL FILE

DATE PREPARED	CHARGE CODE
2/8/80	201
DELIVERY DATE	REQUISITION DATED
2/15/80	2/7/80

☐ 1 F.O.B. DESTINATION
2 F.O.B. SHIPPING POINT PREPAY AND BILL

EF Hutton
One Battery Park Plaza New York, New York 10004
Telephone (212) 742-[illegible]

RELEASE ORDER
MUST BE INSIDE DELIVERY ONLY

RELEASE ORDER NO.
Z- 16102

ABOVE ORDER NO. MUST APPEAR ON ALL PAPERS AND PACKAGES RELATIVE TO THIS ORDER

RE: PURCHASE ORDER
NO.

TS 5000

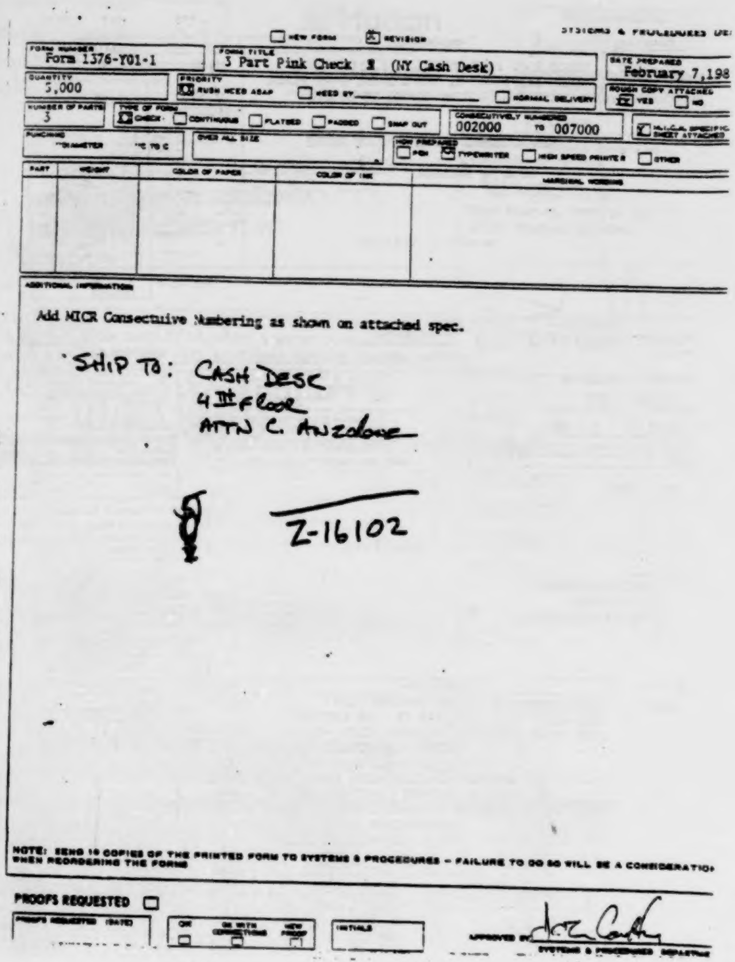
322104

☒ SHIP TO: EF Hutton & Company Inc.
A-One Battery Park Plaza
New York, New York 10004
B-435 Hudson Street
New York, New York 10014

VENDOR
NORTHEAST FORMS
61 BROADWAY
NEW YORK NY 90006

TO
CASH DESK
4TH FL
ATTN: CHARLIE
Attn
Loc.

QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
	[illegible]	22.38	111.[illegible]



SYSTEMS & PROCEDURES DE

☐ NEW FORM ☒ REVISION

FORM NUMBER: Form 1376-Y01-1

FORM TITLE: 3 Part Pink Check # (NY Cash Desk)

DATE PREPARED: February 7,198

QUANTITY: 5,000

PRIORITY: ☒ RUSH NEED ASAP ☐ NEED BY ____ ☐ NORMAL DELIVERY

ROUGH COPY ATTACHED: ☒ YES ☐ NO

NUMBER OF PARTS: 3

TYPE OF FORM: ☒ CHECK ☐ CONTINUOUS ☐ PLATTED ☐ PADDED ☐ SNAP OUT

CONSECUTIVELY NUMBERED: 002000 TO 007000

☒ MICR SPECIFIC SHEET ATTACHED

PUNCHING: "DIAMETER "C TO C

OVER ALL SIZE

HOW PREPARED: ☐ PEN ☒ TYPEWRITER ☐ HIGH SPEED PRINTER ☐ OTHER

PART	WEIGHT	COLOR OF PAPER	COLOR OF INK	MARGINAL WORDING

ADDITIONAL INFORMATION

Add MICR Consecutive Numbering as shown on attached spec.

SHIP TO: CASH DESC
4th Floor
ATTN C. Anzalone

Z-16102

NOTE: SEND 10 COPIES OF THE PRINTED FORM TO SYSTEMS & PROCEDURES – FAILURE TO DO SO WILL BE A CONSIDERATIO WHEN REORDERING THE FORMS

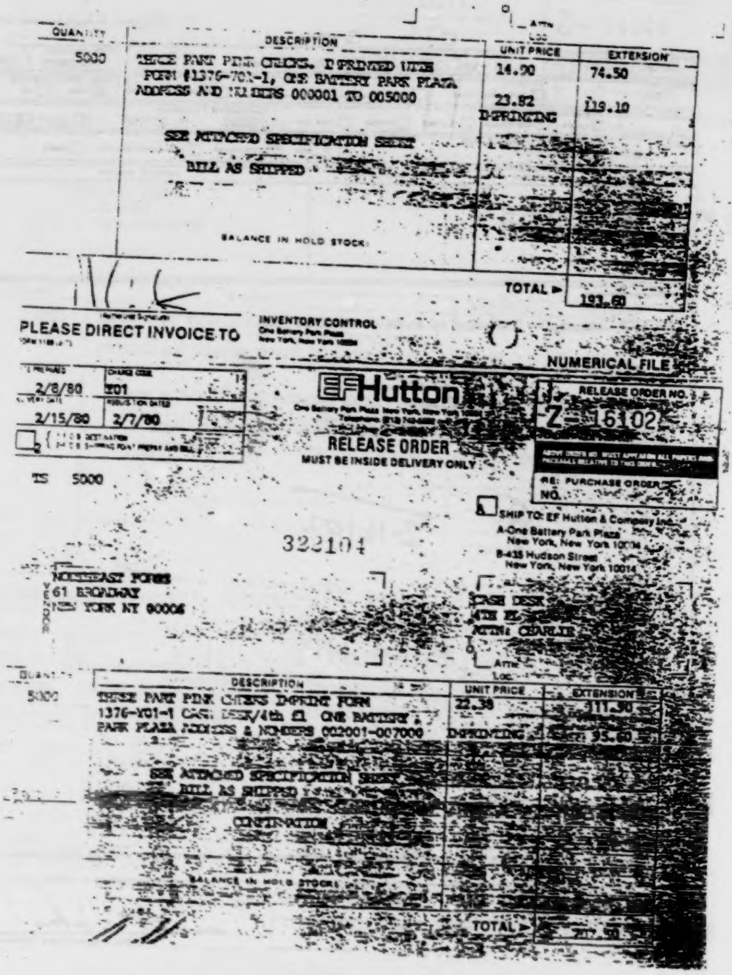
PROOFS REQUESTED ☐

PROOFS REQUESTED (DATE)

OK ☐ OK WITH CORRECTIONS ☐ NEW PROOF ☐

INITIALS

APPROVED BY
SYSTEMS & PROCEDURES DEPARTME



QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
5000	THREE PART PINK CHECKS. IMPRINTED WITH FORM #1376-Y01-1, ONE BATTERY PARK PLAZA ADDRESS AND NUMBERS 000001 TO 005000	14.90	74.50
		23.82 IMPRINTING	119.10
	SEE ATTACHED SPECIFICATION SHEET		
	BILL AS SHIPPED		
	BALANCE IN HOLD STOCK:		
		TOTAL ►	193.60

PLEASE DIRECT INVOICE TO

INVENTORY CONTROL
One Battery Park Plaza
New York, New York 10004

NUMERICAL FILE

DATE PREPARED 2/8/80	CHARGE CODE Y01
DELIVERY DATE 2/15/80	REQUISITION DATED 2/7/80

EFHutton

One Battery Park Plaza New York, New York 10004

RELEASE ORDER
MUST BE INSIDE DELIVERY ONLY

RELEASE ORDER NO.
Z-16102

ABOVE ORDER NO. MUST APPEAR ON ALL PAPERS AND PACKAGES RELATIVE TO THIS ORDER

RE: PURCHASE ORDER NO.

TS 5000

322104

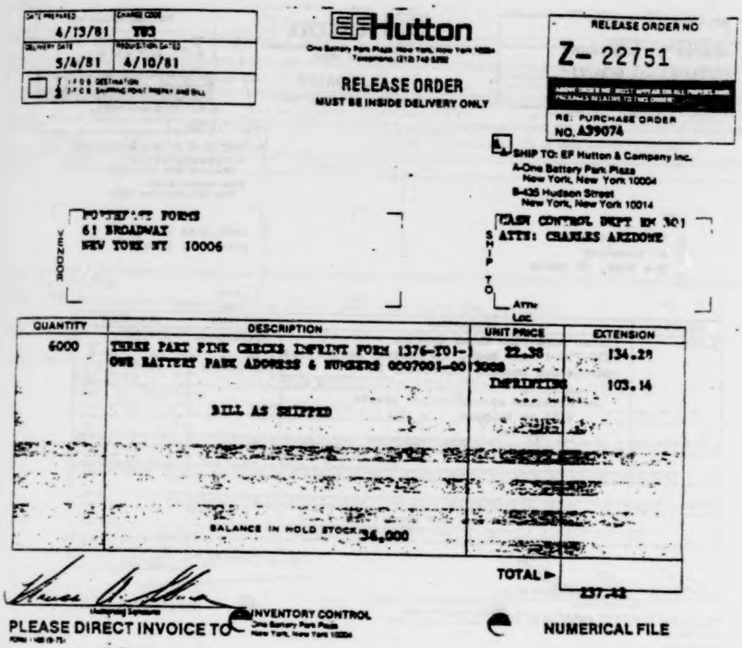
☐ SHIP TO: EF Hutton & Company Inc.
A-One Battery Park Plaza
New York, New York 10004
B-435 Hudson Street
New York, New York 10014

VENDOR
NORTHEAST FORMS
61 BROADWAY
NEW YORK NY 00006

CASH DESK
4TH FL
ATTN: CHARLIE

Attn
Loc

QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
5000	THREE PART PINK CHECKS IMPRINT FORM 1376-Y01-1 CASH DESK/4th fl ONE BATTERY PARK PLAZA ADDRESS & NUMBERS 002001-007000	22.38	111.90
		IMPRINTING	95.60
	SEE ATTACHED SPECIFICATION SHEET		
	BILL AS SHIPPED		
	CONTINUATION		
	BALANCE IN HOLD STOCK:		
		TOTAL ►	[illegible]



DATE PREPARED	CHARGE CODE
4/13/81	YO3
DELIVERY DATE	REQUISITION DATED
5/4/81	4/10/81

☐ 1. F.O.B. DESTINATION
2. F.O.B. SHIPPING POINT PREPAY AND BILL

EFHutton
One Battery Park Plaza New York, New York 10004

RELEASE ORDER
MUST BE INSIDE DELIVERY ONLY

RELEASE ORDER NO
Z- 22751
ABOVE ORDER NO. MUST APPEAR ON ALL PAPERS AND PACKAGES RELATIVE TO THIS ORDER
RE: PURCHASE ORDER
NO. A39074

☐ SHIP TO: EF Hutton & Company Inc.
A-One Battery Park Plaza
New York, New York 10004
B-435 Hudson Street
New York, New York 10014

VENDOR
[illegible] FORMS
61 BROADWAY
NEW YORK NY 10006

SHIP TO
CASH CONTROL DEPT RM 301
ATTN: CHARLES ARZDONE
Attn:
Loc.

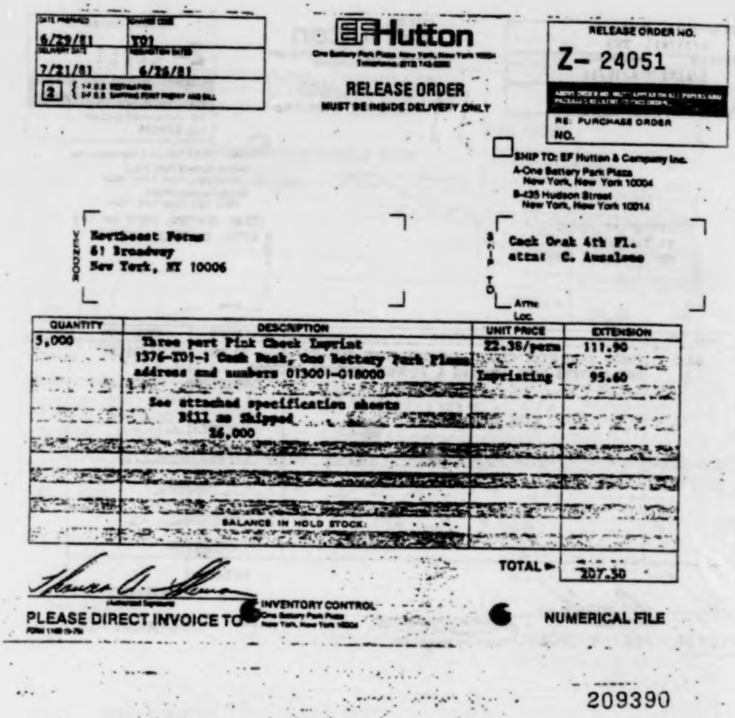
QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
6000	THREE PART PINK CHECKS IMPRINT FORM 1376-Y01- ONE BATTERY PARK ADDRESS & NUMBERS 0007001-0013000	22.38	134.28
		IMPRINTING	103.14
	BILL AS SHIPPED		
[illegible]	[illegible]	[illegible]	[illegible]
	BALANCE IN HOLD STOCK 36,000		

TOTAL ► 237.42

Authorizing Signature

PLEASE DIRECT INVOICE TO INVENTORY CONTROL
One Battery Park Plaza
New York, New York 10004

NUMERICAL FILE



DATE PREPARED	CHARGE CODE
6/29/81	Y01
DELIVERY DATE	REQUISITION DATED
7/21/81	6/26/81

2

EF Hutton

RELEASE ORDER

MUST BE INSIDE DELIVERY ONLY

RELEASE ORDER NO.

Z- 24051

RE: PURCHASE ORDER NO.

☐ SHIP TO: EF Hutton & Company Inc.
A-One Battery Park Plaza
New York, New York 10004
B-435 Hudson Street
New York, New York 10014

VENDOR
Northeast Forms
61 Broadway
New York, NY 10006

SHIP TO
Cash Desk 4th Fl.
attn: C. Ausalone

Attn:
Loc.

QUANTITY	DESCRIPTION	UNIT PRICE	EXTENSION
5,000	Three part Pink Check Imprint 1376-Y01-1 Cash Desk, One Battery Park Plaza address and numbers 013001-018000	22.38/perm Imprinting	111.90 95.60
	See attached specification sheets Bill as Shipped 26,000		
	BALANCE IN HOLD STOCK:		
		TOTAL ►	207.30

Authorized Signature

PLEASE DIRECT INVOICE TO INVENTORY CONTROL
One Battery Park Plaza
New York, New York 10004

NUMERICAL FILE

209390

SYSTEMS & PROCEDURES DEPT.

☐ NEW FORM ☒ REVISION

FORM NO. 1376-Y01-1	FORM TITLE 3 PART PINK CHECK (CASHIERS DEPT/CSH)	DATE PREPARED JUNE 26, 1981
QUANTITY	PRIORITY ☒ RUSH NEED ASAP ☐ NEED BY______ ☐ NORMAL DELIVERY	ROUGH COPY ATTACHED ☒ YES ☐ NO
NUMBER OF PARTS 3	TYPE OF FORM ☒ CHECK ☐ CONTINUOUS ☐ FLAT SET ☐ PADDED ☐ SNAP OUT	CONSECUTIVELY NUMBERED NEXT TO NUMBERS
		☒ M.I.C.R. SPECIFICATION SHEET ATTACHED
PUNCHING "DIAMETER "C TO C	OVER ALL SIZE	HOW PREPARED ☐ PEN ☐ TYPEWRITER ☐ HIGH SPEED PRINTER ☐ OTHER

PART	WEIGHT	COLOR OF PAPER	COLOR OF INK	MARGINAL WORDING

ADDITIONAL INFORMATION

Add MICR Consecutive Numbers to the check. (See spec sheet for position).

Add a large "E.F. HUTTON & COMPANY INC." as shown on attached rough copy.

SHIP TO: Cash Desk
4th Floor
Attn. C. Anzolone

ORD JUN 29, 1981

Z-24051

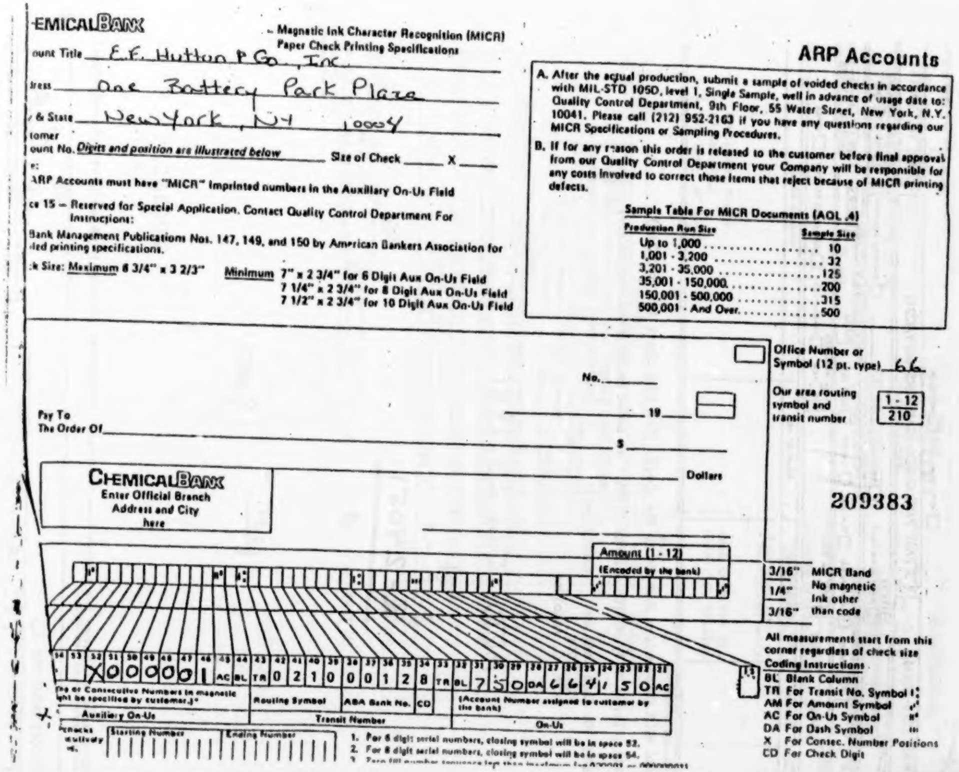
13,001 - 18,000

NOTE: SEND 10 COPIES OF THE PRINTED FORM TO SYSTEMS & PROCEDURES – FAILURE TO DO SO WILL BE A CONSIDERATION WHEN REORDERING THE FORMS

PROOFS REQUESTED ☐

PROOFS REQUESTED (DATE)	OK ☐ OK WITH CORRECTIONS ☐ NEW PROOF ☐	INITIALS

APPROVED BY



EMICALBANK

– Magnetic Ink Character Recognition (MICR)
Paper Check Printing Specifications

ARP Accounts

ount Title E.F. Hutton & Co., Inc.

ress One Battery Park Plaza

/ & State New York, NY 10004

tomer
ount No. *Digits and position are illustrated below* Size of Check ______ X ______

e:

ARP Accounts must have "MICR" Imprinted numbers in the Auxiliary On-Us Field

ce 15 – Reserved for Special Application. Contact Quality Control Department For Instructions:

Bank Management Publications Nos. 147, 149, and 150 by American Bankers Association for iled printing specifications.

:k Size: Maximum 8 3/4" x 3 2/3" Minimum 7" x 2 3/4" for 6 Digit Aux On-Us Field
7 1/4" x 2 3/4" for 8 Digit Aux On-Us Field
7 1/2" x 2 3/4" for 10 Digit Aux On-Us Field

A. After the actual production, submit a sample of voided checks in accordance with MIL-STD 105D, level 1, Single Sample, well in advance of usage date to: Quality Control Department, 9th Floor, 55 Water Street, New York, N.Y. 10041. Please call (212) 952-2163 if you have any questions regarding our MICR Specifications or Sampling Procedures.

B. If for any reason this order is released to the customer before final approval from our Quality Control Department your Company will be responsible for any costs involved to correct those items that reject because of MICR printing defects.

Sample Table For MICR Documents (AQL .4)

Production Run Size	Sample Size
Up to 1,000	10
1,001 - 3,200	32
3,201 - 35,000	125
35,001 - 150,000	200
150,001 - 500,000	315
500,001 - And Over	500

Pay To
The Order Of ______________________________ $ ________

No. ________

________ 19 ____

________ Dollars

CHEMICALBANK
Enter Official Branch
Address and City
here

Office Number or
Symbol (12 pt. type) 66

Our area routing
symbol and
transit number

1 - 12
210

209383

Amount (1 - 12)
(Encoded by the bank)

3/16" MICR Band
1/4" No magnetic ink other
3/16" than code

All measurements start from this corner regardless of check size

54	53	52	51	50	49	48	47	46	45	44	43	42	41	40	39	38	37	36	35	34	33	32	31	30	29	28	27	26	25	24	23	22	21
		X	0	0	0	0	0	1	AC	BL	TR	0	2	1	0	0	0	1	2	8	TR	BL	7	5	0	DA	6	6	4	1	5	0	AC

(…e or Consecutive Numbers in magnetic …ght be specified by customer.)* — Auxiliary On-Us

Routing Symbol — ABA Bank No. — CD — Transit Number

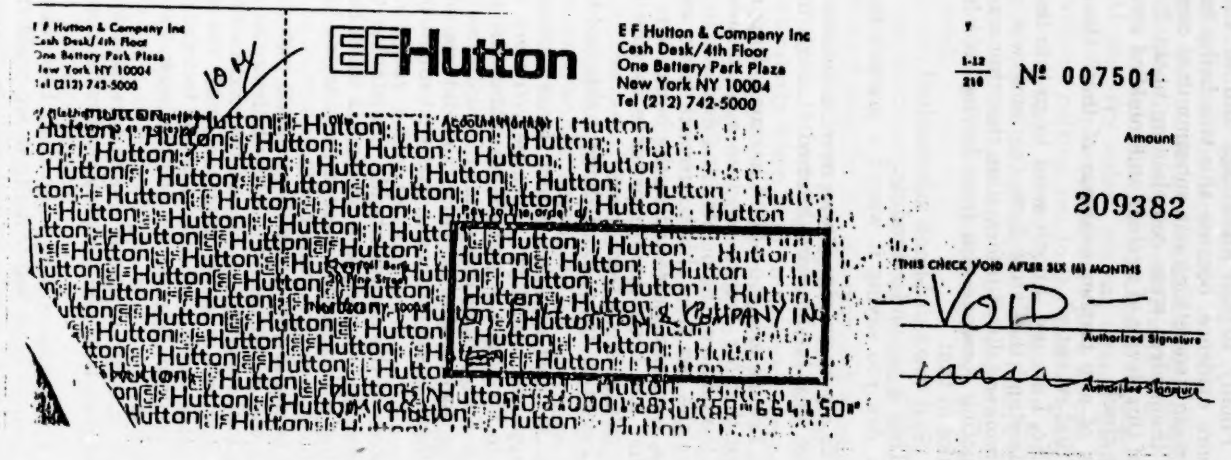
(Account Number assigned to customer by the bank) — On-Us

…checks …utively …d. Starting Number Ending Number

1. For 6 digit serial numbers, closing symbol will be in space 52.
2. For 8 digit serial numbers, closing symbol will be in space 54.
3. Zero fill number sequence less than maximum [illegible]

Coding Instructions

- BL Blank Column
- TR For Transit No. Symbol ⑆
- AM For Amount Symbol ⑇
- AC For On-Us Symbol ⑈
- DA For Dash Symbol ⑉
- X For Consec. Number Positions
- CD For Check Digit



E F Hutton & Company Inc
Cash Desk/4th Floor
One Battery Park Plaza
New York NY 10004
Tel (212) 742-5000

104

EF Hutton

E F Hutton & Company Inc
Cash Desk/4th Floor
One Battery Park Plaza
New York NY 10004
Tel (212) 742-5000

$\frac{1\text{-}12}{210}$ Nº 007501

Amount

209382

Pay to the order of

E.F. Hutton & Company Inc

THIS CHECK VOID AFTER SIX (6) MONTHS

—VOID—

Authorized Signature

Authorized Signature

Mr. **Mazzoli**. Finally, to your knowledge, and Mr. Christopher's, is there any more evidence, because this was being turned in by the bank, this wasn't something our subcommittee came up with, but the banks themselves were complaining about E.F. Huttons persistent use of this device of unclear and muddied up consecutive numbers on the check.

Do you know of any further evidence of that? Have you been made aware of that recently?

Mr. **Fomon**. No, I am not. I don't want to go into the details on that, but I understand the letter from the bank was not a letter relating to the banker's direct information that that was something that he was quoting someone else from having told him that he had no experience in that.

Mr. **Mazzoli**. So it was third-hand information?

Mr. **Fomon**. That is my understanding.

Mr. **Mazzoli**. Are you saying it wasn't a practice for the last 5 months.

Mr. **Fomon**. To my knowledge it was never a deliberate practice. I do not believe any banks were harmed through miscoding of checks.

Mr. **Mazzoli**. Let me ask you—Mr. Chairman, I appreciate your indulgence—first that Mr. Fomon be given a reasonable amount of time to give us the name of the printer and evidence in documentary form of when the last time this occurrence came and also from whatever banks, a question directed to the banks who complained about this. What has been their experience for the last several months? I want to find it out from them.

Mr. **Fomon**. I want to know, too. I thought this had been cleared up already.

Mr. **Mazzoli**. My last question, which I am sure is not heard with any unhappiness, would you, because you were in the room when I talked to Mr. Trott a moment ago about the possibility of you on behalf of E.F. Hutton requesting of the Justice Department copies of all the documentation which you did not yourself keep copies of, and there is some thought that that might be a way out of the impasse.

I recognize some of the documents Mr. Christopher talked about are big thick ones that copying is a problem. I think that is sort of a technical thing which people in good faith trying to get at the truth will be able to overcome very easily.

My question is would you and will you state today to this committee that you will authorize E.F. Hutton to bear the cost of printing or duplicating, copying the cost of the documentation which you have not yourself retained copies of with the proviso that that—my request is made in full light of the fact that some of the documentation would be unnecesary and too thick, too burdensome to be totally copied.

So what I am in effect saying is this is a request for reasonable copying? Would you bear the costs of reasonable copying of that data?

Mr. **Fomon**. I would be willing to do that. I would be willing to bear the cost. I would hope before doing it, we could sit down with the staff and decide that maybe several millions of canceled checks were not pertinent to your inquiry.

Mr. **Hughes**. Will the gentleman yield?

Mr. **Mazzoli**. I would be happy to.

Mr. **Hughes**. In fact, the gentleman's time is about up.

Mr. **Mazzoli**. My time has expired. Thank you.

Mr. **Hughes**. I think that is a reasonable request. We have made that offer. At the very outset, we had offered through counsel to try to agree upon samples and areas where we can garner relevant documents without putting you to the task of producing the voluminous financial records, in particular, that we are talking about.

I just want to say to my colleagues—and I don't want to go back to the concerns that we got into with the Justice Department for the first 2 hours—but that argument may or may not satisfy this committee's need.

I suspect it may not, because we need a lot of relevant documents that Justice has which only Justice can produce which E.F. Hutton doesn't have access to.

But be that as it may, let me, if I may, ask a couple more questions about attorney/client privilege for one thing. We have run into the attorney/client privilege being exercised in a number of instances, particularly when staff investigators were interviewing mid- and high-level people. They exercised the attorney/client privilege, the most gregarious of which, in my judgment, was when staff was interviewing Mr. Rae, as a matter of fact, and a question was asked him which bears on the central issue of knowledge that this practice of kiting checks, this scheme that entered into a mail fraud conviction was wrong, legally wrong.

The question was asked for his opinion, whether he gave any opinions to the company as to the legality of the practice. And he was advised to exercise the attorney/client privilege. That is a central issue, it seems to me. We are going to ask Mr. Rae when he comes here.

I only point it out, Mr. Fomon, because we are running into the exercise of attorney/client privilege in a number of instances with admitted high-level people. My question is is it going to be company policy to free your people up to discuss this evidence, or is it going to be company policy to exercise the attorney/client privilege?

Mr. **Fomon**. I want to find out who was culpable just as much as you do. And if the attorney/client privilege is being exercised to stonewall you or anyone else, I would object to that.

Mr. **Hughes**. Mr. Christopher, do you have anything to add? I can represent to you that that privilege is being exercised, when we get into areas where witnesses start to feel very uncomfortable.

Mr. **Christopher**. Mr. Chairman, let me say this about the attorney/client privilege: of all the committees of Congress, indeed of all the agencies of Government, I would think that your committee composed of lawyers is perhaps the best able to understand the complexity of the attorney/client privilege. I am sure that you understand the risks of waiver of the attorney/client privilege, if you begin to waive it in a given area.

I think the best that I can say to you today is that we intend to exercise the privilege in very limited instances, only in the clearest cases, and we certainly don't intend to use the attorney/client privilege as a way to obstruct your investigation.

If any of that is going on, I assure you it will be stopped. I also think this committee composed of lawyers would certainly not want to force a wholesale waiver of the attorney/client privilege in a way that might go to the heart of that important privilege and importance of its maintenance.

Mr. HUGHES. I can appreciate that, Mr. Christopher. You know, the attorney/client privilege was exercised on behalf of the firm's general counsel as a client, not as the attorney.

Mr. CHRISTOPHER. I am sorry.

Mr. HUGHES. The attorney/client privilege was exercised on behalf of Mr. Rae, the counsel, as the client, not as the attorney.

Mr. CHRISTOPHER. I don't know that particular case.

Mr. HUGHES. The central issue we were trying to determine was whether Mr. Rae, first of all, had knowledge of the kiting practices, the illegal practices; and secondly, whether he had given any legal advice to the company on the propriety of those practices which I think you have to agree are really central to this committee's investigation.

Mr. CHRISTOPHER. Mr. Rae——

Mr. HUGHES. It is surely central to the inquiry by the grand jury. Here you have the legal adviser to the corporation exercising—somebody exercising on his behalf the attorney/client privilege, refusing to answer the question of whether he ever gave legal advice to the company on the issue.

Mr. CHRISTOPHER. As I say, I don't know that case. We will look at it carefully. I can imagine if the question was interpreted as calling for the production of advice he gave to the company, that that might be within the attorney/client privilege. I think you, Mr. Chairman, if I don't presume too much, could also—there was a range of questions that would be proper.

There was a range of questions that might cross that.

Mr. HUGHES. It is interesting you would raise that. In the context of an Arthur Little audit, they became very concerned about the practice. They raised some questions about that. They asked Mr. Rae, as a matter of fact, for a legal opinion.

He said, well, I think the practice is OK basically. When they asked for a written confirmation of that, they refused to give it to him.

Mr. FOMON. I think you are referring to Arthur Andersen.

Mr. HUGHES. Yes. I am sorry. Refused to give them a written opinion on the propriety of that. Be that as it may, one additional housekeeping chore, we requested the minutes of the board of directors meeting, particularly the audit committee of the board of directors.

Has that been furnished? Can you tell us, Mr. Fomon? I haven't seen it.

Mr. CHRISTOPHER. I am told, Mr. Chairman, that has been furnished.

Mr. HUGHES. Was that furnished today?

Mr. CHRISTOPHER. In the boxes yesterday or today I am told, Mr. Chairman.

Mr. HUGHES. Thank you very much. Mr. Fomon, I want to assure you I understand the problems that your company has to have today when you are taking the beating day after day in the media, and I regret that. I am as anxious as you are to complete the investigation; to do our job, to make whatever findings we have to make from the facts so you can get back to the E.F. Hutton business and, we can move on to other things.

Mr. **FOMON**. With our full cooperation, can you give me an estimate of how long this investigation will go on?

Mr. **HUGHES**. Well, I think a lot will depend upon what kind of cooperation we get out of the Justice Department.

Mr. **FOMON**. Thank you.

Mr. **HUGHES**. Our final witness today is Mr. Thomas Rae, general counsel of the E.F. Hutton Group, Inc., E.F. Hutton and Co., Inc.

Mr. Rae, on behalf of the subcommittee, we welcome you. Let the record reflect pursuant to clause 2, rule 11 of the House of Representatives, Committee on the Judiciary and clause 2 of rule 11 of the Rules of the House of Representatives, copies have been made available to you and are available at the witness table.

Mr. Rae, you have a right to have counsel to assist you in the course of this morning's proceedings. Are you accompanied by counsel?

TESTIMONY OF THOMAS RAE, GENERAL COUNSEL AND EXECUTIVE VICE PRESIDENT, THE E.F. HUTTON GROUP, INC., E.F. HUTTON & CO., INC., ACCOMPANIED BY WARREN CHRISTOPHER, COUNSEL

Mr. **RAE**. Yes. I am accompanied by Mr. Christopher.

Mr. **HUGHES**. Mr. Christopher, once again we welcome you.

Mr. Rae, I am now going to place you under oath.

[Witness sworn.]

Mr. **HUGHES**. Mr. Rae, you have a statement which you have submitted which will be made a part of the record in full. You may proceed as you see fit.

Mr. **RAE**. If I could read the statement, it is rather brief, I would be pleased to answer any questions.

Mr. **HUGHES**. Proceed accordingly.

Mr. **RAE**. I am general counsel and executive vice president of E.F. Hutton, Inc. I have served as the company's general counsel since 1968.

One June 7, 1985, I became aware that the company had on that date been served with a subpoena duces tecum calling for production to this committee of a very large number of documents relating to some 19 subject matter categories and covering a 6-month time span. Moreover, the documents requested were physically scattered among more than 400 E.F. Hutton locations throughout the United States.

My staff immediately consulted with outside counsel and determined that a substantial portion of the requested material had been previously assembled in conjunction with the Justice Department investigation and could accordingly be delivered to the committee by the June 14 subpoena return date. Documents totaling some 250,000 pages were, in fact, produced by that date.

At the same time, it was clear to me that it would be physically impossible to produce the remainder of the subpoenaed materials within the time provided. It was for that reason that the company requested, and this committee graciously permitted, a 1-month extension to and including today within which the company might respond.

On June 14 I directed the dispatch of a telex to each relevant E.F. Hutton facility. The telex contained the text of the subpoena together with instructions requiring a diligent search of the facility for the purpose of identifying and compiling all responsive documents. Each office was further directed by the telex and by follow-on telephonic instruction to segregate the compiled documents into two categories. The first category, referred to internally as "correspondence," consisted of all correspondence, memoranda, and notes. The second category consisted of journals, blotters, drawdown sheets and other routine cashiering work product.

Simultaneously, discussions were taking place between committee counsel and our outside counsel directed toward an understanding which would eliminate the need for us to forward and the committee staff to review vast volumes of technically responsive materials which were not likely to contain much of interest or significance.

On my return from the July 4 holiday weekend, I was advised by a member of my staff that an agreement had been reached limiting production to documents constituting correspondence, memoranda, or notes. On July 12, a second telex was sent to all E.F. Hutton facilities instructing them to immediately forward to my office—by overnight mail by the way—all documents of that character which were included among and previously segregated materials.

Since July 10, I have had 5 to 17 attorneys and 9 paralegals working full time on our document production. They have been physically located at a 10,000 square foot facility in New York which the company has leased to accommodate its document production effort as well as its ongoing Bank Restitution Program. They have worked from 9 a.m. to 9 p.m. each business day, as well as all day Saturday and Sunday this past weekend.

I am pleased to report that as a result of their extraordinary effort we yesterday made and by the close of business today will be making additional productions which, by our rough calculation, will provide the committee with an additional 40,000 pages of correspondence, memoranda, and notes.

We believe these materials represent the overwhelming bulk of the correspondence, memoranda, and notes responsive to the committee subpoena. As in every large document production, however, there are some individuals and offices who, whether because of illness, vacation, or other compelling reasons, have not been able to complete the review of their files and the assembly of their documents. We are, of course, continuing our efforts with respect to these matters and will be supplying the committee with a limited number of additional documents as soon as they are available.

Mr. **Hughes**. Thank you very much, Mr. Rae.

Mr. Rae, I gather the documents we subpoenaed—I know on June 14, 1985, a wire was sent to offices ordering them to compile the relevant documents. However, according to that wire, they were instructed not to send the documents to New York.

Your statement says it was not until last Friday that the word went out to send the material to New York. How did this happen?

The subpoena was served on June 7. Why did we wait until basically a week ago before you started mobilizing the forces to collect this information?

Mr. **Rae**. Mr. Chairman, my initial instruction to the field was to segregate, assemble, and hold. At that point—and we are currently holding an additional 10,932 boxes in the field containing an estimated 22 million documents which we did assemble pursuant to your subpoena.

I was advised by outside counsel that they were continuing to have discussions with your staff with respect to the scope of the subpoena, the type of material that would ultimately be produced, and I understand until such time as an agreement had been reached, we had determined to assemble the material, gather the material and then on a notice it could be airborne into New York City.

Mr. **Hughes**. Who specifically told you that?

Mr. **Rae**. The firm of Cahill & Gordon.

Mr. **Hughes**. Who in particular in that firm? That is not accurate. That is absolutely inaccurate.

Mr. **Rae**. They talked to another member of my staff. My understanding is Mr. Tom Kavaler of that firm. He talked to another member of my staff.

Mr. **Hughes**. It is a situation where the left hand doesn't know what the right hand is doing, because there was no agreement to narrow. There was an attempt to narrow initially and that was repudiated by the company, and we endeavored to try to narrow the scope and agree upon the particular sample financial documents. That was rejected. So I——

Mr. **Rae**. It is my understanding you did want all notes and all memorandums, and we have furnished those documents today.

Mr. **Hughes**. I find it incomprehensible you waited until a week ago until you started to marshal these documents. We had a hearing a month ago in which these documents were to be produced, and 3 weeks into that you still weren't marshaling documents for this committee. We have read about documents in the newspapers from time to time.

Mr. **Rae**. June 14, Mr. Chairman, we began assembling the gathering, collection, and categorizing of the documents.

Mr. **Hughes**. Yes, but you instructed the branches not to deliver them to this central headquarters.

Mr. **Rae**. Until further notice, that is correct.

Mr. **Hughes**. How could you possibly comply with Mr. Fomon's representatives that this committee would have all those documents within a month if you didn't begin to assemble them until a week ago?

Mr. **Rae**. If there was a misunderstanding with the staff, as a result I apologize for it, but I must make clear, Mr. Fomon's mandate to me was to fully cooperate with this staff in any way, if I needed additional individuals or staff or facilities to make those available. If we are talking to the manner in which we gathered and the time and there is a misunderstanding, I apologize.

The commitment and mandate I received from Mr. Fomon was very clear, to make full cooperation with this committee in attempting to get each and every document within the scope of your subpoena delivered to this committee.

Mr. **Hughes.** I find your explanation just implausible. Your suggestion there was some snafu, staff differences I just don't accept. Let me move on to the more central issue, Mr. Rae. You are general counsel to the firm, a firm who has pleaded guilty to 2,000 counts of mail and wire fraud. At any time during the period that the aggressive overdrafting took place, did you visit anyone in the company on the legality, the propriety of that practice?

Mr. **Rae.** There was only one occasion, Mr. Hughes, until obviously I became aware in late February or March 1982, that the purported improprieties may be occurring, a conversation I had in February or March 1982 with representatives of Arthur Andersen and the head of the cash mobilization department, a Mr. William Sullivan.

Mr. **Hughes.** You had no knowledge of the aggressive overdrafting that took place prior to that time?

Mr. **Rae.** I did not.

Mr. **Hughes.** You were never asked for any legal opinion as to the legal propriety of the so-called aggressive overdrafting?

Mr. **Rae.** If you would like me to discuss that meeting, I would be pleased to.

Mr. **Hughes.** I will get to that.

Mr. **Rae.** That was the only discussion——

Mr. **Hughes.** I am trying to determine if that was the only discussion.

Mr. **Rae.** Until a member of my staff was advised representatives of the New York State Banking Commissions and representatives of the Federal Reserve System wanted to have a meeting with Hutton; that they were concerned about certain practices that came to their attention. That was in February 1982.

Mr. **Hughes.** Did you render an opinion at that time?

Mr. **Rae.** I attended the meeting. I listened to what the representatives said, and we immediately launched an inquiry. I advised executives I was concerned about the allegations. We immediately upon any indication that certain of our offices were doing multiple drawdowns, that activity by wire was directed to be stopped in February.

We continued in a sense a query to determine whether this has been merely an aberration or an exception in our system or was widespread. As we continued that, we finally concluded in May, because additional evidence was coming to our attention, it might be more widespread than first indicated, so we closed down our entire money management system. We began a system of only drawing on collected balances.

I had by that time, or in fact in February, hired an outside law firm to assist us in making an inquiry.

We employed the firm of Arthur Young to come in and explore our systems and to devise what they would hope would be an entirely appropriate system. Shortly thereafter, the grand jury convened in the middle district of Pennsylvania and a grand jury investigation commenced.

Mr. **Hughes.** What I am trying to find out—and I don't think you have answered the question, Mr. Rae—is whether at any time you rendered any opinion, legal opinion, as to the propriety of aggressive overdrafting.

Mr. **Rae**. I would like to indicate, the only time I expressed a legal opinion was in February 1980. I think, in fairness, I would like to describe that conversation with Arthur Andersen & Co. Arthur Andersen had——

Mr. **Hughes**. Why don't you answer the question first, and then you can explain it.

Mr. **Rae**. I received an explanation together with Arthur Andersen Co. from Mr. Sullivan to explain our basic drawdown system in February 1980. We wanted to make certain it was not like a similar system that had been addressed by the California courts some years earlier.

There was nothing in his explanation, nothing in the system we could determine was in any way improper, unlawful, or in any way any impropriety.

Mr. **Hughes**. So your answer is you did render an opinion at that time?

Mr. **Rae**. On the basis of what Mr. Sullivan conveyed, and in several hours of discussion for the benefit principally of Arthur Andersen. I was a catalyst setting up the meeting.

Mr. **Hughes**. Arthur Andersen expressed concerns because there were a lot of overdrafts.

Mr. **Rae**. Arthur Andersen expressed no concerns whatsoever at that time.

Mr. **Hughes**. How was it brought to your attention?

Mr. **Rae**. They were trying to compare our practices of overdraft. We had a money management system which had been in place, I believe, since about 1977. There were no known complaints that system was in any way improper. I had never heard of any complaints, and Arthur Andersen was not questioning it on the basis of any information that came to their attention.

It was basically educational to again go through and understand precisely how the cash mobilization department operated.

Mr. **Hughes**. Wasn't the triggering factor a court decision that has been handed down which dealt with similar practices? Wasn't the context in which you were asked the question as to whether or not practices at E.F. Hutton, the overdrafting at E.F. Hutton, were in fact proper, legal practices? Wasn't that the context?

Mr. **Rae**. The practice, as in that litigation in California were totally dissimilar to what E.F. Hutton was doing. I recall the facts because they had an advance sheet, and it was a business that did business solely in the State of California. But apparently it established at least 1,000 banking accounts for no legitimate business purpose other than to run moneys through them.

Second, there appear to be the corporations had no agreements, understandings of any kind with the banks that they had the relationships with or where they maintained the accounts, and in fact, there seemed to be some suggestion whether they had the means or the intent of being able to repay obligations they were creating.

At that time we had apparently legitimate business organizations as far as bank accounts. We had one at each bank office. It would be drawn up to a regional drawdown system, and then go to the east coast or west coast. They were designed to afford each and every bank an adequate and fair return on collected balances at the end of each month.

At the same time, there was an overdraft aspect in it on the basis of a formula. It might depend on the amount you had in collected balances, the amount of cash you deposited with the banks that day, the amount of checks written on the bank that day.

Mr. **Hughes**. Were you familiar with that practice?

Mr. **Rae**. Not until I attended that meeting. Basically, Mr. Sullivan spent 2 hours for the benefit of Arthur Andersen and myself.

Mr. **Hughes**. Once you were familiar with that practice, drawing down a certain percentage—once you understood what the practices and procedures were, were you asked for legal opinions to the legality of those practices and procedures?

Mr. **Rae**. They asked is that distinguished from the TI case? And I said, "Absolutely, we are talking about night and day figures."

Mr. **Hughes**. Were you asked for the legality—listen to my words. Were you asked an opinon as to the legality, the propriety of that practice?

Mr. **Rae**. They asked me to prepare, if I would——

Mr. **Hughes**. Is that a tough question? I will rephrase it. My question is——

Mr. **Rae**. I was not at the meeting.

Mr. **Hughes**. My question is, Were you asked for an opinion as to the legality?

Mr. **Rae**. On legality, no. I was asked an opinion as to whether I was comfortable or there was distinguishment between our system and TI. I was not there because of any suspicion by anyone, including Arthur Andersen, there were no improprieties. They had come up with a court case 2 or 3 years earlier and wanted to make certain we didn't come with any of the practice—the egregious facts of that case were not in any way similar to what Hutton was doing or conducting.

Mr. **Hughes**. I want to be fair. Let me see if I understand your testimony. Your testimony is you were never asked for a legal opinion as to the legality or propriety of that practice. You were asked for an opinion only as to whether it is distinguishable from this other——

Mr. **Rae**. I further opined to them at that time I saw nothing we heard that day or in Mr. Sullivan's explanation, which included, by the way, his offer to call any bank in the United States in which we maintained the relationship to demonstrate to us that they understood the agreement, whether it was written or implied.

I thought I opined to them verbally, but I did not feel it necessary to write a legal opinion because, quite frankly, I thought it was a bit of an annoyance. They had not questioned any of the activities. It was merely understanding the difference between our system and one described some 3 years before in a TI organization.

I advised Arthur Andersen if they had any stronger feelings to come back or if he felt he needed something, fine, or to consult with his own counsel. But I didn't refuse to, nor was there any question raised to any improprieties——

Mr. **Hughes**. Didn't you take a legal position at that meeting if there was a means to pay that overdrafting under the circumstances, it was permissible?

Mr. **Rae**. That is one of the elements discussed, first of all, in any banking system, obviously; the intent and the means. I think that is even more traditional when you are talking about criminal check kiting.

Mr. **Hughes**. The answer to my question is "yes"?

Mr. **Rae**. The third element I added which was very important was the understandings of the bank, whether they be written, implied, or agreed to, that the bank had an understanding of the activities they were conducting on their books.

Mr. **Hughes**. Were you asked for a written opinion?

Mr. **Rae**. He asked if I might give an opinion. I was talking to Bill and I was talking to Joel. I said, "Joel, I don't think it is necessary, but I see nothing similar. I saw nothing described today that indicates any impropriety." And basically it was more an annoyance, because I did not opine anything in the system suggested impropriety.

Mr. **Hughes**. You were asked for a legal opinion and did not give that. That would not be accurate?

Mr. **Rae**. Not in the context I said I will give you a verbal——

Mr. **Hughes**. Weren't you asked for a legal opinion?

Mr. **Rae**. He asked me for one.

Mr. **Hughes**. Didn't you refuse to give him one?

Mr. **Rae**. I told him if he felt strongly I would. We heard nothing at the meeting to indicate it wasn't perfectly appropriate. I have no reason to believe it wasn't so.

Mr. **Hughes**. Mr. Rae, I find it very difficult to believe something so central to the practice of E.F. Hutton, first of all, was not reduced to writing. We have information which we will provide for you that suggests that you were asked for a legal opinion and refused to give one.

Are you telling us today that that—I want you to think about this—that that is not accurate?

Mr. **Rae**. Mr. Hughes—and I have testified in full about this before the grand jury, so it comes as no surprise. I testified fully. At the end of the conversation we were all satisfied——

Mr. **Hughes**. I don't want to know anything that went before the grand jury.

Mr. **Rae**. I was asked for a written opinion. I declined a written opinion, not out of reluctance to write it, but annoyance of my time under the circumstances where there had been nothing indicated that was improper by any party.

Mr. **Hughes**. I find that hard to believe.

The gentleman from Florida.

Mr. **McCollum**. Mr. Rae, in this whole process of the E.F. Hutton case, I see a lot of bankers, and I have had any number of bankers say to me even what E.F. Hutton said was legal, in the end and even some of the residual procedures that are there were something that under no circumstances would they have ever agreed to and can't imagine bankers agreeing to that in these procedures.

So it occurs to me that you as counsel to Hutton in this circumstance would have been in position to have at least sensed that there might have been something wrong here, whether you did or not and whether you want to be bored with it or not. It occurs to me one of the big problems with this whole matter is there were too many people at E.F. Hutton too busy doing something else rather than using good common sense to say, hey, there is a red flag, as we would say in the law.

You know what we mean by that. There was a big red flag here in my mind when I saw that, and I would have thought when you had that meeting, if that was the only meeting you had—I know you are a businessman—that should have raised a red flag to you somebody down the road might not be too liking to that and accept we have got a grievance with hundreds of banks across the country to do that this way, maybe by implication, when an area like this could be absolutely criminal, if it is not done right.

That should have raised a big red flag with you. I am surprised you are telling us today it didn't. Am I correct you didn't have any questions about that procedure when you took an initial glance and heard what you did from the people you discussed with Mr. Hughes you had a discussion with?

Mr. **Rae**. Mr. McCollum, the system had been running approximately 2½ years before that took place. To the best of my knowledge, I had never heard a single complaint from any member of the E.F. Hutton organization who came to my office. There hadn't been a single complaint from any banking organization.

I had never heard any suggestion of any impropriety Arthur Andersen was aware of, and I never had a suggestion any way, shape or form. We are not talking about a period in time in which the Federal grand jury cited us for violations. As far as I know, there were no multiple drawdowns taking place in February 1980. The violating period we are talking about is July 1980.

Mr. **McCollum**. The problem I have with it isn't that you are under any indictment or anything like that, but just as the counsel for a major corporation like this, it is just incredible to me that you did not think that this was worth pursuing on your own initiative. Even though nobody said to you, "hey, this is a big problem," it didn't occur to you it may be a big problem?

Mr. **Rae**. I thought a great deal about that in hindsight. Obviously, my devotion was in making certain our conduct of transactions with public investors—and there are over a million public investors—and what view—I was not a banking expert.

Mr. **McCollum**. Let me interrupt you here. Did your office draw up the agreements with this bank?

Mr. **Rae**. No.

Mr. **McCollum**. Who would have drawn that up in your shop?

Mr. **Rae**. We did not. That is 1978.

Mr. **McCollum**. There were no agreements with the bank?

Mr. **Rae**. There may have been with some. On the other hand, you would walk in, talk with the banker and discuss it, because every month most bankers would come in and have a discussion as to the profitability of that or the nonprofitability of your account with the bank.

Mr. **McCollum**. Whether there is anything legal or illegal, it is a very high indictment of the procedures of your organization in my eyes. It is one of the big problems we have with this whole case is even if there isn't anything more and Justice did an absolutely appropriate job of all this, there is a real record of awfulness about all this procedurally.

Let me ask you a question related to why we originally had the hearing scheduled today. Are there any records that can be produced to us from the discussions you have heard—you have been sitting in the audience today—that are over in front of that grand jury?

There are some Mr. Christopher referred to a few minutes ago that fall into this gray area that got over there that perhaps were not originally realized you didn't keep copies at the Hutton shop. Do you know more about this than Mr. Christopher? He obviously has just been retained, and you have been dealing with this for some time.

Mr. RAE. I would like to break it down into two areas. First is what we furnished, and daily banking records. That is a great bulk of the 6 million. We did not make copies of that. We do have receipts we gave them boxes that represent canceled checks for a certain period.

We have that much identification. It is gone. The time in photocopying them is overwhelming. In the other area, it was the policy and the procedure of when memos and notes went to the grand jury, we would keep photocopies of those notes and memos that were submitted to the grand jury. It appears in some instances several boxes may have been sent, because we were dealing with a vast and huge amount, array of materials that went to the grand jury, but we did not get a copy of those for E.F. Hutton.

Mr. MCCOLLUM. Do you have a way of discerning what those were without going over there and going through everything based on what you know you did send, the general categories? Is that something so that working with Justice that will be a simple thing to determine or is this something that will drag on?

Mr. RAE. I think it can be addressed promptly. We do have logs of material furnished and we can address that with all the documents that come in pursuant to this House subpoena.

We are going to address that promptly, and as I think Mr. Fomon indicated, also to the extent we find any document that was not previously submitted to the grand jury and fell within the parameters of their subpoena will be promptly furnished to this committee.

Mr. MCCOLLUM. We appreciate this cooperative spirit, and I have nothing more.

Mr. HUGHES. I recognize the gentleman from Connecticut.

It is my expectation that we will have to convene another hearing probably sometime in early September after we have had an opportunity to go through many of the documents. I want to say to Mr. Fomon before he leaves, and I leave here, he is still under subpoena and we may need his testimony again, Mr. Christopher. I think not, but it may be necessary.

I am going to ask the gentleman from Connecticut if he will chair the hearing at this point to complete the line of questioning in about four areas we want to go into.

Mr. MORRISON [presiding]. I would be glad to.

Mr. MCCOLLUM. I am going to have to leave as well. It is no disrespect. We are together responsible for having this go a little longer than we intended. I appreciate the cooperation of the witnesses today and certainly the chairman's indulgence.

Mr. HUGHES. And I thank the witnesses also.

Mr. CHRISTOPHER. I wonder if I might thank you for your cooperation today. And it won't be necessary to subpoena Mr. Fomon. He will be back here.

Mr. HUGHES. I know that is the case. I appreciate that. As I have indicated, we have enjoyed excellent cooperation in the last few days, and we are delighted you are on board to assist us in trying to wade through this very complex situation. We appreciate that.

Mr. MORRISON. Mr. Rae, I would like to direct your attention to the following matter. Last Tuesday, the subcommittee staff interviewed Hutton's central regional sales master, Ernie Dipple, and when that interview took place, he was accompanied by his counsel, a person by the name of Tom Curnin, who is a Cahill Gordon lawyer.

Cahill Gordon represents your company, does it not?

Mr. RAE. It did then, that's correct.

Mr. MORRISON. Does it come with your responsibilities as general counsel to be involved in the relationship betwen E.F. Hutton and its outside counsel?

Mr. RAE. In most cases, yes.

Mr. MORRISON. Cahill Gordon is the firm that was representing your company in these proceedings?

Mr. RAE. Yes, it was.

Mr. MORRISON. In the ultimate plea in court as well?

Mr. RAE. Yes, it was.

Mr. MORRISON. At this meeting, Mr. Dipple produced a document which I would like to introduce into the record, a November 3, 1981 letter from Commerce Bank of Kansas City to John Latshaw, your central regional vice president. The bank asked Hutton for more than $200,000 because of Hutton's consistent overdrafting of its bank account, and our staff asked him to obtain the document, and he replied he had gotten it from his lawyer, Mr. Curnin, who gave it to him recently.

Now, I am concerned about this, and the committee is concerned as to what kind of legal advice is being given by our outside counsel when they have a document that is clearly within the scope of a subpoena from this committee and it is being withheld and has to be discovered in this manner?

Can you comment on that; explain what kind of instructions have been given to you or by you to counsel, outside counsel, that would lead them, your own counsel, to withhold documents clearly within the scope of the subpoena? This is not about rummaging through boxes. This is in the possession of your own counsel.

[The information follows:]

NOTICE: If the film image below is less clear than this notice, it is due to the quality of the document being filmed.

November 3, 1981

Mr. John Latshaw
Executive Vice President
E. F. Hutton & Company, Inc.
920 Baltimore
Kansas City, Missouri 64105

Dear John:

We have incurred a loss totaling $210,310.45 on the E. F. Hutton account relationship for the period from January through October of this year. This deficit is detailed as follows:

Month	Monthly Loss	Quarterly Loss	Cumulative Loss
January	$ 7,443.54		$ 7,443.54
February	312.03		7,755.57
March	13,962.53	$ 21,718.10 (1st)	21,718.10
April	6,792.50		28,510.60
May	12,600.01		41,110.61
June	13,536.24	32,928.75 (2nd)	54,646.85
July	13,850.29		68,497.14
August	56,222.41		124,719.55
September	78,911.21	148,983.91 (3rd)	203,630.76
October	6,679.69		210,310.45

On May 19, 1981, John Owen and Larry Holden called on Tom Morley and were told that our year to date compensation would be analyzed and that the account would be restored to a profitable basis. The losses continued, but we were assured by telephone that the problem would be corrected. Larry Holden again called on your firm on September 15, 1981, and was asked to submit a bill for the third quarter loss and he was told this would be promptly paid. We were requested at that time to use our 1980 profit on the E. F. Hutton accounts to offset the loss for the first six months of 1981. We indicated that our profit last year was quite small in relation to this year's loss and that under no circumstances could it be used to offset any portion of the sizeable deficit incurred in 1981.

We have continued to service the E. F. Hutton accounts despite the substantial losses we have suffered because we have been assured on numerous occasions by representatives of your firm

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notice it is due to the quality of the document being film

Mr. John Latshaw
Page 2
November 3, 1981

that the accounts would be restored to a profitable basis. Since this has not happened, we have no alternative but to request payment of $210,310.95 at this time.

We have previously furnished you with the analysis of each month's activity with us. As support for the enclosed bill of $210,319.95, attached you will find an additional copy of the detailed information supporting the above review of account losses. We are requesting you reimburse us this $210,310.45 and that you provide us your check in payment of this bill by November 13, 1981. Any losses on the account in future months will be billed by the 5th of the month and we shall expect payment by the 15th.

We appreciate your understanding and cooperation.

Very truly yours,

David W. Kemper
Senior Executive Vice President

DWK/kj
Enclosures

Mr. **Rae.** I am unfamiliar with the situation you are addressing. We have not, I think, in any way advised outside counsel, nor I think any inside counsel, to in any way withhold documents that this committee is entitled to and is within the scope of their subpoena.

Mr. **Morrison.** You have not advised them to withhold? Have you advised them to make sure they produce such documents?

Mr. **Rae.** All of our law firms in fact have had an active role in the assembly, the gathering and furnishing of documents to this committee.

Mr. **Morrison.** We had some discussion with Mr. Fomon about attorney/client privilege, and we had a comment from Mr. Christopher on that subject. I certainly concur with Mr. Christopher any attorney, certainly the members of this committee, needs to be sensitive to the attorney/client privilege. It serves an important function in our system.

On the other hand, what was suggested is that there would be a case-by-case looking at what—and a narrow application of this doctrine, not a broad scale anything that has been touched by a lawyer is not somehow going to come forward.

Have you instructed outside counsel to come to you and to come to the principals of the company when there is a question about whether something ought to be disclosed because they are concerned about the privilege?

Mr. **Rae.** We are attempting to coordinate with internal counsel. When this issue arises—you never know when it is going to arise, to produce something that he feels is attorney/client.

It may be his own work product. Certainly I think where the privilege is raised, it has been raised for bona fide reasons. And we are willing to discuss if there are areas to agree it has been improperly raised or technically raised in the spirit of meeting the House's response.

There is no plan in any way to improperly impose or to assert the privilege.

Mr. **Morrison.** Have you communicated with Cahill Gordon your intention that they endeavor to comply completely with the subpoena in regard to any records in their possession or at least to bring them to you so a discussion can be had about the privilege?

Mr. **Rae.** I think all law firms have the commitment made to cooperate with this committee and furnish all documents responsive to your subpoena.

Mr. **Morrison.** Have you communicated in writing?

Mr. **Rae.** No. I have been speaking with that firm on a daily basis many times a day.

Mr. **Morrison.** So we have your assurance—it is quite recently—when was your meeting?

Mr. **Rae.** Just in the last several days. I have been with that firm on a daily basis, together with the other gentleman involved in this on a daily basis.

Mr. **Morrison.** Can you explain to me then how it is that Cahill Gordon shows up in a meeting representing one of your employees and all of a sudden produces—it is produced but has not produced previously—this critical document that shows in 1981 your firm was very much on notice that one of these banks which you say was very happy with all of this and not at all concerned is writing a letter asking for $200,000 in compensation for aggressive overdrafting in valuation of what they understood to be your treatment with them?

Mr. RAE. Since I wasn't there, I will certainly attempt to get a response from Cahill Gordon. It is difficult for me to address why an attorney did something in a meeting in which I wasn't present. I don't know what occurred.

I don't know the circumstance of the document. But if you would like, I would be happy to get back to you a response to your question.

Mr. MORRISON. Take it from us, this document was something that should have been disclosed earlier and was not disclosed through any initiative of the law firm or of E.F. Hutton, but came to light only because of questioning of a particular employee.

That is unacceptable. That is not cooperation. That is not what we are looking for. And I would hope you would formalize your request to counsel that you say has been made in written form and supply this committee with a copy of it so we can see they are really being told in an affirmative way not to let anything languish in their files so we don't have another set of George Ball memos like the ones stashed away in some office, hidden away in some law firm records, that may come to light after we finish our investigation.

Can we have that?

Mr. RAE. Yes. I will try to find the facts and circumstances relating to your concern with Mr. Dipple and Cahill.

[The information follows:]

O'MELVENY & MYERS
1800 M STREET, N. W.
WASHINGTON, D. C. 20036-5857
TELEPHONE (202) 457-5300
TELEX 89-622 (202) 833-3673 (ODD)

400 SOUTH HOPE STREET
LOS ANGELES, CALIFORNIA 90071-2899
TELEPHONE (213) 669-6000
TELEX 67-4122 · 4997795 (ITT)

1800 CENTURY PARK EAST
LOS ANGELES, CALIFORNIA 90067-1589
TELEPHONE (213) 553-6700
TELEX 67-4087

610 NEWPORT CENTER DRIVE
NEWPORT BEACH, CALIFORNIA 92660-6429
TELEPHONE (714) 760-9600 · (213) 669-6000
TELEX (714) 760-1367 (ODD) · 4722088 (ITT)

880 FIFTH AVENUE
NEW YORK, NEW YORK 10019
TELEPHONE (212) 247-4040
TELEX 127006

October
30th
1 9 8 5.

OUR FILE NUMBER
408,100-27
WRITER'S DIRECT TELEPHONE
(202) 457-5901

Honorable William J. Hughes
Chairman
Committee on the Judiciary
U.S. House of Representatives
341 Cannon House Office Building
Washington, D.C. 20515

Dear Chairman Hughes:

This responds to your request for clarification of the facts and circumstances relating to the fact that a 1981 document was produced to the Committee for the first time in an interview with Mr. Dipple. That document had been provided to Mr. Dipple by his counsel, Cahill, Gordon & Reindel, who also included it in Hutton's principal production of documents pursuant to the schedule established with your staff in June. This production took place on July 19, and therefore followed the interview of Mr. Dipple.

Sincerely,

Zoe E. Baird
for O'MELVENY & MYERS

cc: Honorable Bruce A. Morrison
Hayden W. Gregory, Esq.
Virginia Sloan, Esq.

O'MELVENY & MYERS

1800 M STREET, N. W.
WASHINGTON, D. C. 20036-5887
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TELEX (714) 760-1397 (DDD) · 4765058 (ITT)

880 FIFTH AVENUE
NEW YORK, NEW YORK 10019
TELEPHONE (212) 247-4040
TELEX 127009

November
11th
1 9 8 5

OUR FILE NUMBER
408,100-27
WRITER'S DIRECT TELEPHONE
(202) 457-5901

Honorable William J. Hughes
Chairman, Subcommittee on Crime
Committee on the Judiciary
U.S. House of Representatives
341 Cannon House Office Building
Washington, D.C. 20515

Dear Chairman Hughes:

This responds to your request for clarification of the facts and circumstances relating to the fact that a 1981 document was produced to the Subcommittee for the first time in an interview with Mr. Dipple.

I understand that the document in question had been given to Mr. Dipple by his counsel, Cahill, Gordon & Reindel, in preparation for his interview by this Subcommittee and provided at that interview with his counsel's knowledge. Although the arrangements for when documents were to be produced predated our representation of Hutton, I understand that the facts are as follows. This document also was provided to the Subcommittee as part of Hutton's substantial production, which took place the week of July 17-22 and therefore followed the interview of Mr. Dipple. Included in that production was over 40,000 pages of correspondence and memoranda.

As is customary in document production, documents are collected in a central location and provided in bulk rather than a file at a time as they are located. Of course, we had no control over the document production before we were retained, and the bulk of the documents you requested were provided within a week thereafter as a result of document collection efforts that had begun weeks before. This met the final production date discussed by yourself with Mr. Fomon at the June hearing. Any attempt at piecemeal production would have diverted Hutton lawyers and paralegals and delayed the final production date.

Sincerely,

Zoe E. Baird

cc: Honorable Bruce A. Morrison
Hayden W. Gregory, Esq.
Virginia Sloan, Esq.

Congress of the United States
House of Representatives

437 Cannon House Office Building
Washington, DC 20515

Bruce A. Morrison
Member of Congress
Third District, Connecticut

November 14, 1985

Zoe Baird, Esquire
O'Melveny & Myers
1800 M Street, N.W.
Washington, D.C. 20036

Dear Ms. Baird:

Congressman Hughes has asked me to respond to your letter regarding my requests for information at the Subcommittee on Crime's July 19 hearing on the E.F. Hutton case. As you know, I asked for information on two different matters. In my opinion, your letter responds to neither.

First, I asked Hutton's General Counsel Thomas Rae how it happened that a document clearly responsive to the Subcommittee's subpoena duces tecum, returnable on June 14, was not produced until counsel to the Subcommittee met with Central Region Sales Manager Ernest Dippel and his lawyer, Thomas Curnin of Cahill Gordon & Reindel, on July 16. As you know, Mr. Curnin also represents Hutton. I refer, of course, to the letter from David W. Kemper, Senior Executive Vice President of the Commerce Bank of Kansas City, to Hutton Regional Vice President John Latshaw, complaining that his bank had incurred losses of $210,310.45 as a result of Hutton's overdrafting scheme.

Lest my concerns were not made perfectly clear at the hearing (and I think they were), let me state them again. The Subcommittee's subpoena was returnable on June 14 and Hutton did not comply. On June 19, Chairman Hughes and Robert Fomon discussed the matter of Hutton's non-compliance and they agreed that Hutton would fully comply in four weeks. Mr. Fomon promised the Chairman that "we'll get the memos to you right away." On June 26, Mr. Curnin, responding to Mr. Dippel's request for the bank letter, sent him a copy. Obviously, then, close to the time the subpoena was returnable, both Hutton and Mr. Dippel knew that the letter existed. Given that the Curnin letter was dated only

District Office
[illegible]
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Washington Office
437 Cannon House Office Building
Washington, DC 20515
Telephone (202) 225-[illegible]

Committees
Judiciary
Banking, [illegible]
Select Committee [illegible]
Youth and Families

Chairman,
Democratic New Members Caucus

New England [illegible]

Representing
[illegible]
[illegible]
East Haven
Guilford
Hamden
Killingworth
Madison
[illegible]
New Haven
North Branford
North Haven
Orange
[illegible]
[illegible]
West Haven
Woodbridge
[illegible]

Zoe Baird, Esquire
Page Two
November 14, 1985

12 days after the return date, and that Mr. Dippel had had to request it earlier than that date, it is fair, I think, to assume that Hutton's counsel (who at the time was responsible for document production to the Subcommittee) knew about the letter at the time of production and yet did not produce it.

I asked Mr. Rae two things: 1) how this situation could have occurred and 2) to "formalize [his] request to counsel that [he said had] been made in written form and supply this committee with a copy of it so we can see they are really being told in an affirmative way not to let anything languish in their files...."

Your letter describes the efforts of O'Melveny & Myers after it was retained to comply with the Subcommittee's subpoena. While I think the Subcommittee would agree that your firm has improved Hutton's compliance, it is irrelevant in this context. That the document was also finally produced on July 19 is also irrelevant. I want to know when Mr. Curnin obtained the Commerce Bank letter and why it was not produced to the Subcommittee on June 14.

In addition, I want a copy of Mr. Rae's directive to Hutton's counsel that Hutton employees be told not to let documents "languish" in their files. Obviously, my concern was that Hutton had not cooperated with the Subcommittee. Mr. Rae assured me that that situation had changed, and I wanted written assurances that it had. Your letter does not speak to this issue at all.

I know that this is the second letter you have sent in an effort to respond to my requests. I do not understand what the difficulty is, since I do not believe my requests were ambiguous. The Subcommittee will print your letter in the hearing record (along with relevant correspondence and documents). If you wish to submit a third letter, you may do so, but please be advised that your response is all that is delaying the printing of both the June 19 and July 19 hearings, and that the Subcommittee will send the record for a final print on Friday, November 22.

Sincerely,

Bruce A. Morrison

Bruce A. Morrison
Member of Congress

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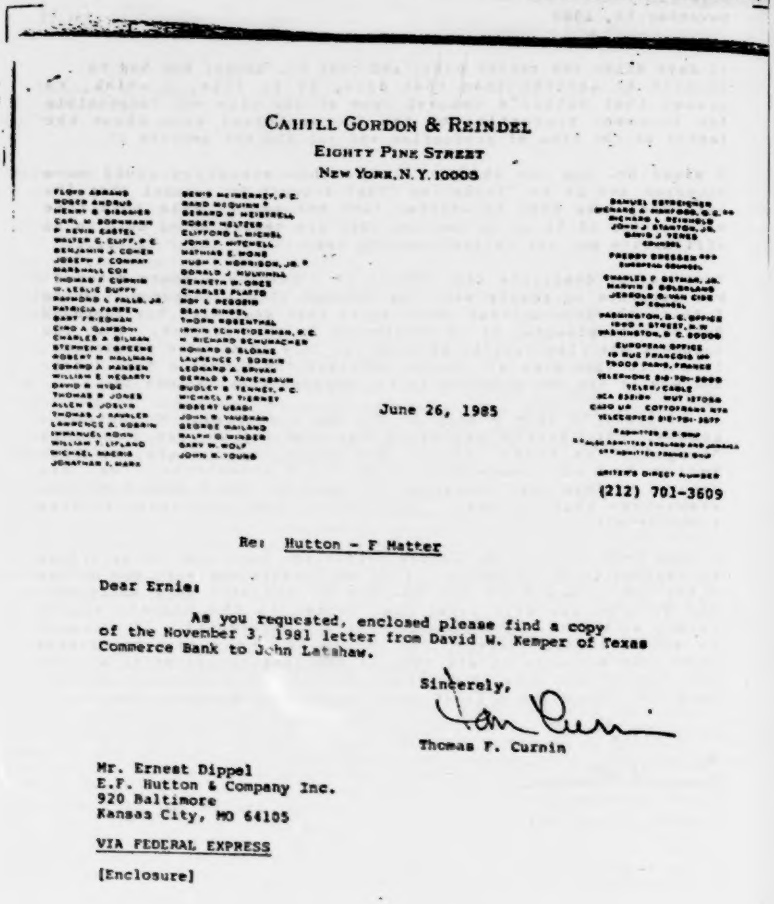

CAHILL GORDON & REINDEL
EIGHTY PINE STREET
NEW YORK, N.Y. 10005

WASHINGTON, D. C. OFFICE
1990 K STREET, N.W.
WASHINGTON, D. C. 20006

EUROPEAN OFFICE
19 RUE FRANCOIS 1ER
75008 PARIS, FRANCE

WRITER'S DIRECT NUMBER
(212) 701-3609

June 26, 1985

Re: Hutton - F Matter

Dear Ernie:

As you requested, enclosed please find a copy of the November 3, 1981 letter from David W. Kemper of Texas Commerce Bank to John Latshaw.

Sincerely,

Tom Curn

Thomas F. Curnin

Mr. Ernest Dippel
E.F. Hutton & Company Inc.
920 Baltimore
Kansas City, MO 64105

VIA FEDERAL EXPRESS

[Enclosure]

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November 3, 1981

Mr. John Latshaw
Executive Vice President
E. F. Hutton & Company, Inc.
920 Baltimore
Kansas City, Missouri 64105

Dear John:

We have incurred a loss totaling $210,310.45 on the E. F. Hutton account relationship for the period from January through October of this year. This deficit is detailed as follows:

Month	Monthly Loss	Quarterly Loss	Cumulative Loss
January	$ 7,443.54		$ 7,443.54
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October	6,679.69		210,310.45

On May 19, 1981, John Owen and Larry Holden called on Tom Morley and were told that our year to date compensation would be analyzed and that the account would be restored to a profitable basis. The losses continued, but we were assured by telephone that the problem would be corrected. Larry Holden again called on your firm on September 15, 1981, and was asked to submit a bill for the third quarter loss and he was told this would be promptly paid. We were requested at that time to use our 1980 profit on the E. F. Hutton accounts to offset the loss for the first six months of 1981. We indicated that our profit last year was quite small in relation to this year's loss and that under no circumstances could it be used to offset any portion of the sizeable deficit incurred in 1981.

We have continued to service the E. F. Hutton accounts despite the substantial losses we have suffered because we have been assured on numerous occasions by representatives of your firm

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Mr. John Latshaw
Page 2
November 3, 1981

that the accounts would be restored to a profitable basis. Since this has not happened, we have no alternative but to request payment of $210,310.95 at this time.

We have previously furnished you with the analysis of each months activity with us. As support for the enclosed bill of $210,319.95, attached you will find an additional copy of the detailed information supporting the above review of account losses. We are requesting you reimburse us this $210,310.45 and that you provide us your check in payment of this bill by November 13, 1981. Any losses on the account in future months will be billed by the 5th of the month and we shall expect payment by the 15th.

We appreciate your understanding and cooperation.

Very truly yours,

David W. Kemper
Senior Executive Vice President

DWK/kj
Enclosures

O'MELVENY & MYERS

400 SOUTH HOPE STREET
LOS ANGELES, CALIFORNIA 90071-[illegible]
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610 NEWPORT CENTER DRIVE
NEWPORT BEACH, CALIFORNIA [illegible]
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OUR FILE NUMBER
408,100-027
WRITER'S DIRECT TELEPHONE
(202) 457-5901

November
22nd
1 9 8 5

Honorable Bruce A. Morrison
437 Cannon House Office Building
Washington, D.C. 20515

Dear Congressman Morrison:

I am sorry that my letter of November 11, 1985 to Chairman Hughes did not make clear to your satisfaction Hutton's position regarding production of the Commerce Bank letter.

It is my understanding that Hutton undertook in discussions with the Subcommittee staff before June 14 to produce correspondence, memoranda and notes responsive to the subpoena as soon as was reasonably possible. Hutton understood this arrangement to have been confirmed in Mr. Fomon's discussion with Chairman Hughes at the June 19 hearing. The process of collecting these large quantities of documents was commenced expeditiously before June 14.

As you have noted, the outside date for compliance was established as four weeks after the June 19 hearing, but both before June 14 and thereafter Hutton and its attorneys were collecting documents, reviewing them for relevance and privilege, numbering them, and otherwise preparing them for production to the Subcommittee. The Commerce Bank letter to which you refer was among those documents gathered for production. Mr. Curnin possessed that document before June 14, but it would be highly unusual -- and extremely inefficient -- in any document production to produce each relevant document as it is found by counsel responsible for production, as I explained in my earlier letter. Any attempt to do so would only have resulted in delaying the date production was complete. Hutton and its counsel did not believe (and do not) that this is what the Subcommittee wished.

As to your suggestion to Mr. Rae at the hearing on July 19 that he confirm in writing his instructions to counsel to cooperate fully with the Subcommittee, Mr. Rae responded that yes, he would consider doing that. As you know, production of all the correspondence, memoranda and notes responsive to the Subcommittee's subpoena was substantially completed either on that day or the day after. Given that fact, there was no longer any need at that point for Mr. Rae to send out such communications.

Sincerely,

Zoë Baird

Zoe E. Baird

cc: Honorable William J. Hughes
Hayden Gregory, Esq.
Virginia Sloan, Esq.

ZEB:pnc

Mr. **Morrison**. Now, the subpoena requested documents related to meetings or other discussions of Hutton's board of directors about their cash management policies. In a June 14 letter, one of the Cahill Gordon lawyers, Thomas Kavaler, asserted that there were no responsive documents except for the minutes of the meeting.

Now, we had a discussion—what is the status of this request with respect to the minutes?

Mr. **Rae**. It is my understanding, we will furnish you all minutes of the board of directors' meeting or the audit committee that make any reference to the matters cited in the indictment.

Mr. **Morrison**. Are verbatim transcripts made of board of directors' meetings?

Mr. **Rae**. No.

Mr. **Morrison**. Are there notes used to prepare the minutes?

Mr. **Rae**. I am certain the secretary of the corporation has some system for trying to recall what occurs in the meetings.

Mr. **Morrison**. Are you agreeing to supply also the underlying notes?

Mr. **Rae**. I will determine if any notes exist, and to the extent they do in that regard. I assume they checked on that in going through the subpoena.

Mr. **Morrison**. No one would feel free today to destroy those notes, would they, in your company?

Mr. **Rae**. I don't think so.

Mr. **Morrison**. If they exist, you will produce those as well?

Mr. **Rae**. Yes.

[The information follows:]

O'MELVENY & MYERS

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July
31st
1 9 8 5

OUR FILE NUMBER
408,100-027
WRITER'S DIRECT TELEPHONE

BY HAND

The Honorable William J. Hughes
Chairman
Subcommittee on Crime
House Committee on the Judiciary
341 Cannon House Office Building
Washington, D.C. 20515

Dear Chairman Hughes:

In response to the Committee's pending request for production of underlying notes or other documents relating to meetings of the Board of Directors and the Board's Audit Committee which refer to E. F. Hutton's cash management policies or other matters covered by the indictment, we enclose the only two documents which have been identified as responsive to that request.

Very truly yours,

Robert C. Vanderet
of O'MELVENY & MYERS

Enclosures

cc: Hon. Bruce A. Morrison
Hayden W. Gregory, Esq.

AUDIT COMMITTEE 3/21/83

LAW, COLIGN & ROBERTSON ON PHONE

LYNCH, RAE, PIERCE, CASTELLANO
AND GARDONE PRESENT

AUDEN MATTER - 45 M

F MATTER

A.A. REJOINED
J. MILLER, R. FLOWERS, DON MCNEIL

NO MATERIAL WEAKNESS IN INTERNAL CONTROL

120 MM DIFFERENCE IN FORMULA CREDITS
- NO VIOLATION

> INDEMNITY DISCLOSURE

THE E.F. HUTTON GROUP INC.
AUDIT COMMITTEE MEETING
APRIL 24, 1984

OUTLINE

- 1983 Blueback Topics
  - Dividends
    - Weaknesses noted in procedures for timely transfer to overage accounts and segregation of certain duties.
    - Experiencing problems in the processing of GNMA principal and interest distributions (this is a pervasive problem in the industry).
  - Syndicates
    - Significant improvement in Accounting's analytical efforts noted due to a reorganization of responsibilities.
    - Problems continue to exist in the manual allocation of syndicate control accounts to appropriate financial statement captions as well as accounting for syndicates at regional locations.
    - Need for further improvement in communications between Investment Banking Group and Accounting, particularly related to unusual deals structured at year-end.
  - Tax Shelters
    - Procedures to be strengthened in handling of cash receipts.
    - Accrual vs. cash-basis accounting.
  - EDP Backup
    - Backup procedures not fully implemented.
    - A formalized plan has been developed with offsite space having been leased and backup hardware presently being acquired.
- Legal
  - 100% confirmation with outside counsel
  - Status of Baldwin-United Rehabilitation Plan
  - Status of Washington Public Power Supply System litigation
  - Federal Grand Jury investigation
- First Pyramid Life Insurance Company of America
- Areas of Internal Audit Department assistance
- New Businesses
  - E.F. Hutton Mortgage Corporation
  - The E.F. Hutton Indemnity Group

Mr. **Morrison**. Are the minutes of that meeting the only discussions at the board level, committees of the board level, on this question of overdrafting, the policy of overdrafting and the plea? We don't have anything from your board of directors. We have nothing.

Mr. **Rae**. The board minutes will speak for themselves. My recollection is that there are 3 minutes that deal with it, the plea, and I think there were earlier two board meetings where they received a summarization of what was occurring during the course of the grand jury investigation in the middle district of Pennsylvania.

Obviously, the minutes will speak for themselves.

Mr. **Morrison**. Are there minutes of the board?

Mr. **Rae**. Yes; as well as the whole board.

Mr. **Morrison**. Your commitment is, all the minutes of all the board meetings and any underlying notes which have any relationship to the overdrafting policy or to this——

Mr. **Rae**. Yes; that has always been my understanding.

Mr. **Morrison**. It has been a long time. We haven't seen any yet.

Mr. **Rae**. I think it is included in the material being forwarded. I know it is on tables in New York.

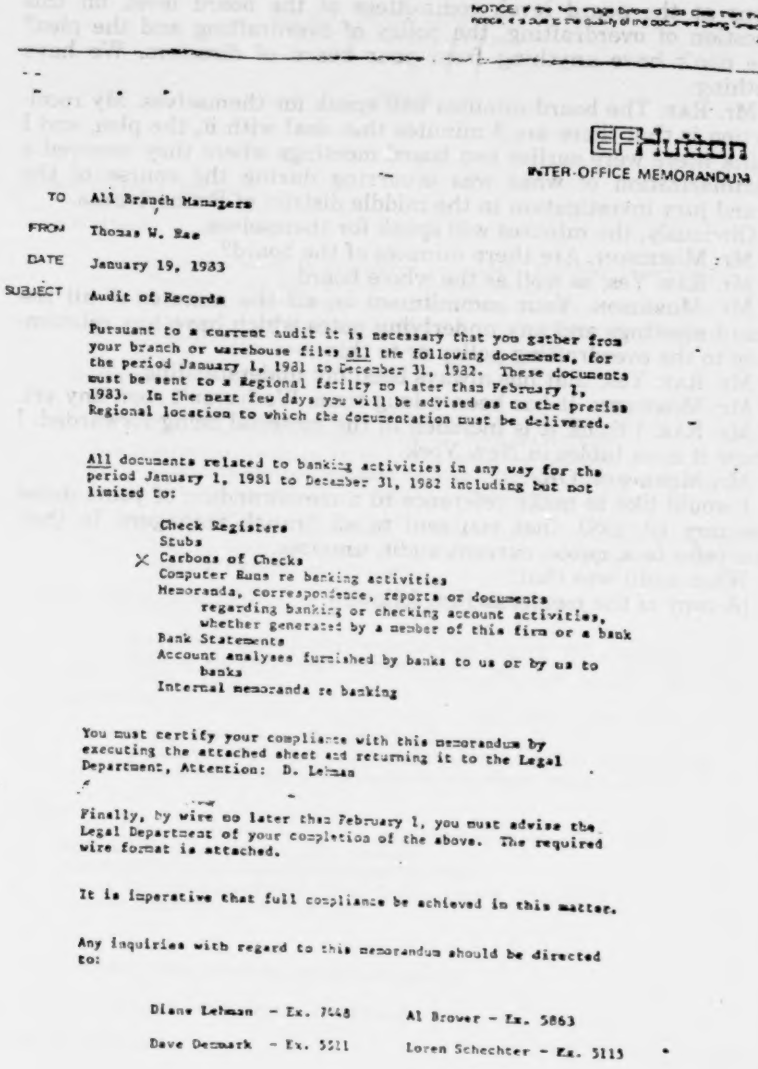
Mr. **Morrison**. OK.

I would like to make reference to a memorandum of yours dated January 19, 1983, that you sent to all branch managers. In that, you refer to a, quote, current audit, unquote.

What audit was that?

[A copy of the memorandum follows:]

NOTICE: If the film image below is less clear than the notice, it is due to the quality of the document being filmed.



EFHutton

INTER-OFFICE MEMORANDUM

TO All Branch Managers

FROM Thomas W. Rae

DATE January 19, 1983

SUBJECT Audit of Records

Pursuant to a current audit it is necessary that you gather from your branch or warehouse files all the following documents, for the period January 1, 1981 to December 31, 1982. These documents must be sent to a Regional facility no later than February 1, 1983. In the next few days you will be advised as to the precise Regional location to which the documentation must be delivered.

All documents related to banking activities in any way for the period January 1, 1981 to December 31, 1982 including but not limited to:

Check Registers
Stubs
X Carbons of Checks
Computer Runs re banking activities
Memoranda, correspondence, reports or documents regarding banking or checking account activities, whether generated by a member of this firm or a bank
Bank Statements
Account analyses furnished by banks to us or by us to banks
Internal memoranda re banking

You must certify your compliance with this memorandum by executing the attached sheet and returning it to the Legal Department, Attention: D. Lehman

Finally, by wire no later than February 1, you must advise the Legal Department of your completion of the above. The required wire format is attached.

It is imperative that full compliance be achieved in this matter.

Any inquiries with regard to this memorandum should be directed to:

Diane Lehman - Ex. 7448
Al Brower - Ex. 5863
Dave Denmark - Ex. 5521
Loren Schechter - Ex. 5115

Mr. **Rae**. Mr. Morrison, that was gathering additional data pursuant to a subpoena for the Federal grand jury in the middle district of Pennsylvania.

Mr. **Morrison**. So that audit you described——

Mr. **Rae**. There was no audit. The audit was the gathering of those materials pursuant to a subpoena from the middle district.

Mr. **Morrison**. So there was no other record or purpose made. There was no other internal investigation with respect to that item?

Mr. **Rae**. No; it was a gathering of documents.

Mr. **Morrison**. When that was going on, what kind of internal investigation were you doing, or were you just pumping out documents to the grand jury and doing no other investigation?

Mr. **Rae**. Well, this may have been covered. Obviously, we felt we had taken remedial steps to the extent that there were no excessive drawdowns taking place or multiple drawdowns. In the meanwhile, during the course of the grand jury, we felt inhibited to the extent of launching our own investigation in fear, No. 1, it would be deemed to be obstructive of the grand jury investigation being carried on.

We obviously had certain employees who had independent counsel who were called or appeared before that grand jury. It would raise questions. That is why when we came to the plea we then had to determine what courses of action we should take with respect to personnel actions, and that was obviously the employment of George Ball, and we are now awaiting the results of his study.

Mr. **Morrison**. On May 2, 1985, Hutton put out an overview, a public statement about what had gone on here, and in that document it was said the company conducted an internal investigation of the activities in question early in 1982. You have just told me you didn't really conduct an investigation. Which is it? You did an investigation or you didn't?

[A copy of the document follows:]

EF Hutton

May 2, 1985

I. OVERVIEW

Today E.F. Hutton & Company Inc., the broker/dealer subsidiary of The E.F. Hutton Group Inc., pleaded guilty to violation of the mail and wire fraud statutes with respect to the Company's handling of its domestic checking accounts at certain commercial banks during the period July 1, 1980 to February 28, 1982. No criminal charges were brought against The E.F. Hutton Group or against any individual. The charges were filed in Scranton in the United States District Court for the Middle District of Pennsylvania.

For 82 years, E.F. Hutton has been committed to setting and maintaining the highest standards of corporate conduct. The practices to which the Company has pleaded guilty represent a serious breach of those standards. For that breach, the Company and its top management assume full responsibility. The Company assumes responsibility because it stands accountable for activities undertaken in its name and because, in this instance, the Company is responsible for failing to have imposed what in retrospect were needed controls in internal bank deposit concentration procedures. The fact that senior management stopped the practices in question when brought to their attention early in 1982 does not alter the company's fundamental accountability.

(more)

This Company believes it has an obligation -- to its shareholders, clients, employees, and the public at large -- to explain as best we can what happened, why it happened, and what we have done about it. The purpose of this memorandum is to provide those details.

Without in any way minimizing the Company's responsibility or the seriousness of what has occurred, we believe it is important to place this event in its proper context.

- The practices to which the Company pleaded guilty, which ended in early 1982, did not involve or jeopardize customer or client funds, and the Company did not in any manner violate its fiduciary duty to its customers or clients. The Company's most fundamental commitment is to its customers and clients, and that commitment was not breached. The violations relate solely to the operation of the Company's own checking accounts at commercial banks, and the parties the Company is charged with having harmed are exclusively commercial banks. Likewise, the violations did not involve the Company's dealings with securities or commodities firms or the Company's investment banking operations. Nor did the Company fail to comply with the multitude of federal and state regulatory requirements to which it is subject.

- Without diminishing the Company's responsibility, the practices in question violated the Company's overall policies and philosophy. When the first individual instance of the practices subsequently found illegal came to the attention of management in December 1981, those practices were ordered by management to stop and were stopped. When senior management later became aware that those practices might have been more widespread, the Company began an internal investigation which led to the immediate curtailment of all those practices. In short, the practices in question were stopped as soon as senior management became aware of them and in the subsequent three years have not recurred.

- The Company has taken steps to assure that those practices will never recur in the future. In the period from February to May 1982, various communications were sent to regional and branch personnel clarifying and revising the details of existing cash concentration procedures. Those communications are described in greater detail in a subsequent section of this Memorandum. Arthur Young & Company, which is nationally recognized for its expertise on this subject, was brought in to review and recommend changes in the Company's practices in this area, and those recommendations were subsequently implemented. An extensive computer system is being installed which, among numerous other features, will automate branch cashier and drawdown functions, which will further enhance our ability to monitor practices on a branch and regional level.

- While the government's investigation was underway, the Company could not take personnel actions without compromising its own legal position and the legal position of employees called before the grand jury. With that inquiry now complete, the Company is in a position to take such individual personnel actions as are appropriate.

- The Company will provide full and prompt compensation to any bank that was injured. The Company has established a restitution program that will cover any losses, including subsequent interest, suffered by banks at which the Company had checking accounts in the 1980-1982 period. The ultimate level of restitution, because it includes interest on the banks' losses, will exceed the earnings which accrued to the Company through the illegal activities.

- The Company has agreed to pay a criminal fine of $2 million plus an additional $750,000 to defray the costs of the investigation by the Government. Under federal law, each mailing or use of the wires is a separate offense. To reach the agreed-upon fine of $2 million, the Company pleaded guilty to 2,000 counts of fraud because there is a maximum fine of $1,000 for each use of the mails or wires.

° Payment of the criminal fine and implementation of the restitution program will not have an adverse financial impact upon the Company. In addition to reserving $2.75 million to cover the criminal fine and prosecution costs, the Company has established a reserve of $8 million to cover potential restitution, including subsequent interest, to the banks. The costs of those reserves have already been reflected in the Company's published earnings and will not affect future earnings. The Company is confident that the restitution reserve will be more than adequate to cover restitution to the banks.

II. KEY ELEMENTS OF PLEA AGREEMENT

In a companion civil case, the Company consented to an injunction forbidding it from using certain banking practices or techniques without the prior consent of the banks involved. The Company is also prohibited from using the two practices to which it pleaded guilty.

The violations arose out of abuses of the Company's system for collecting funds received by its then-existing 300 domestic branch offices and transferring those funds to central "concentration accounts" where they are used to meet corporate cash needs. The Government is not challenging the legality of Hutton's basic system of collecting and moving funds from its branches to central locations; the violations stemmed from abuses of that system. Those abuses were halted when they came to the attention of senior management early in 1982.

In general, the Company was charged with misusing the "float" that arises in the banking system in the interval between the time a check is deposited in a bank and the time that the depository bank collects those funds from the bank on which the check was drawn. Specifically, the acts to which the Company has pleaded guilty were:

- "excessive drawdowns" -- intentionally and persistently withdrawing, or "drawing down," bank deposits in excess of the amount called for by Hutton's formula before the checks creating those deposits had cleared. Excessive drawdowns permitted the Company, in effect, to obtain interest-free loans.

- "multiple transfers" -- transferring funds successively through several banks on their way to the Company's central concentration accounts in New York and Los Angeles, hoping to benefit from potential increases in the float that might arise from random delays in the check clearing system.

The Government's document notes, and the Company agrees, that the Company's aggregate drawings against uncollected balances for the 20-month period exceeded well over $1 billion. This does not mean that there was ever $1 billion of such drawings at one time, but that the sum of the individual daily drawings against uncollected balances exceeded $1 billion over the 20-month period. More important, this aggregate figure includes legal activity as well as drawdowns involving the practices to which the Company has pleaded guilty. Drawings against uncollected balances are a common and accepted practice among corporate depositors; it is only when such drawings become "excessive" on an average daily basis that they become improper.

For example, if for illustrative purposes we assume that over the 20-month period there were 600 days on which the Company drew against uncollected balances of $3 million per day, that activity would produce a sum of $1.8 billion (600 days x $3 million).

Scope of Illegal Practices

On the basis of an internal inquiry, the Company has identified 20 offices out of the firm's 300 then-existing domestic branches which may at some point have engaged in intentional excessive drawdowns. In some but by no means all instances, the character of those transactions was ambiguous, and thus the figure of 20 may include offices that engaged in drawdown practices that were not culpable. For purposes of this disclosure, the Company is classifying all transactions that were at least "questionable" as excessive.

The multiple transfer practice, which involved previously undefined areas of the law, was more prevalent. The Company has identified 83 offices that engaged in this practice at some point during the 1980-1982 period.

In view of the complexity of these transactions and limitations in then-existing management information systems, the Company's data on the number offices which might have engaged in these practices may not be definitive. However, we are confident that the figures provided above represent an accurate measure of the order of magnitude of such practices, and, in any event, any modification of the final figure would not impugn the adequacy of the published reserve.

While the Company believes it important to disclose the scale and extent of these practices, the Company is not identifying the particular offices involved. That decision reflects several considerations. First, we believe it is clear that the practices were terminated three years ago when they came to the attention of senior management, and the Government has not charged that such practices subsequently recurred. Second, the Company has pleaded guilty and is offering full restitution to any injured parties. Under the circumstances, we believe it would be unfair to identify Hutton employees who were carrying out practices that they did not believe were illegal or violative of Company policy. With respect to the number of individual commercial banks that might have been injured, the Company will not be in a position to determine precisely how many banks suffered injury until the claims have been received and evaluated.

III. HUTTON'S CASH CONCENTRATION SYSTEM

Introduction

The purpose of Hutton's cash concentration system is to move funds from its local branches as quickly as possible to central accounts in either New York or Los Angeles where the Company can use the funds. The system calls for the money to move from local banks where Hutton's branches are located to banks in Hutton's regional headquarters cities and then to the central accounts.

Hutton's policy has been that its banks should retain -- on average but not necessarily on any particular day -- enough collected funds to adequately compensate the banks for their services. At the same time, Hutton does not wish to leave additional funds in the banks since that would deprive the Company of the use of its own money. Between July 1, 1980 and February 28, 1982, however, Hutton drew against a number of its accounts to a greater extent than the banks expected, with the result that those accounts were in uncollected positions and the banks were in effect making interest-free loans to the Company.

The Hutton System

The system described here is legal; a later section describes improper variations.

The device Hutton uses to move its funds from local to regional and finally national bank accounts is called a depository transfer check (DTC). These are checks drawn on a Hutton account in one bank and deposited in another. Each day, the Hutton local branch cashier takes the amount deposited that day in the local bank and, applying an approved formula, informs the regional cashier of the amount to be drawn down; the regional cashier then draws a DTC for that amount on the local bank account and deposits the DTC in the regional bank. Later the same day a similar process occurs between the regional cashiers and the national cash desk. This process in effect moves funds from local branches through the banking system to Hutton's central accounts overnight. The formula is designed to leave certain amounts of collected funds (on average) on deposit in local and regional banks to compensate them for their services.

There are two circumstances when a Hutton regional office may write a DTC for more than the amount deposited that day in the local bank. Hutton does this to maintain its average collected balance at the level deemed appropriate to compensate the bank.

Immediately available funds. One circumstance involves immediately available funds. Hutton's daily deposits in local banks regularly include cash, wire deposits and checks written on the same bank in which Hutton has an account. These funds are available to Hutton on the same day they are deposited. They do not need to be collected by the local bank from another bank. Leaving these funds on deposit in the local bank until they are transferred the next day when the DTC clears allows the bank an extra day's use of the funds.

Therefore, Hutton developed a formula which allows for DTCs to be written in excess of the amount actually deposited that day, thus reducing the average collected balance in the account and bringing bank compensation closer to the targeted level. The system adjusts itself each day, making up for excesses or deficiencies in the amount on deposit.

The float. The second circumstance involves the "float." As used here this is the difference between the time a check is scheduled to clear and the time it actually clears. Many checks clear between banks within one day, either through the Federal Reserve System, correspondent bank networks or local bank clearing houses. The Federal Reserve System is committed to clearing all checks within two days.

Sometimes, because of weather or mechanical failure, checks take longer to clear then they are scheduled to. There is a "float." If a Hutton DTC does not clear when scheduled that means Hutton's money stayed in the local bank an extra day or longer, and the local bank benefitted from the extended use of Hutton's money.

Hutton believes it is entitled to share in the float on its own checks. Therefore, it created a mechanism to "recapture" the float when its DTCs failed to clear on time. As with the correction for immediately available funds, DTCs are increased so that the average local bank balance would be adjusted downward to meet the target average balance.

Preventing overdrafts. In either event, should it appear in writing increased DTCs that an overdraft might result (i.e., that a check might be presented to a bank without funds on deposit to cover it), Hutton corrects the situation by depositing one of its own checks (a "branch reimbursement check") drawn on a special bank account in New York. Thus, Hutton does not attempt to draw out of the bank more than has been deposited there.

The operation of Hutton's drawdown system is described in greater detail in the Appendix.

The Illegal Practices

The Government has not brought criminal charges involving the basic operation of E. F. Hutton's cash concentration (or "drawdown") system described above. The Government has asserted that Hutton should have announced to its banks how its drawdown system operated including, in particular, the fact that the system was designed to draw against uncollected funds when necessary to adjust bank compensation. The Government has not charged that the failure to make such announcements, by itself, constituted criminal conduct. It was and is Company policy that the banks with which it deals should be informed of the general nature of the transactions the Company intends to undertake, although adherence to this policy in the July 1980-February 1982 time frame was inconsistent. Pursuant to the terms of the civil injunction Hutton will be forbidden from engaging in a number of practices in the area of collected balance management -- including, in particular, intentionally drawing on uncollected funds -- without prior written agreement or consent of the bank involved.

The two practices which the Government has, however, charged and to which Hutton has pleaded guilty are described below.

(A) Excessive Drawdowns

In a number of instances Hutton personnel caused DTCs to be issued in arbitrary amounts far in excess of those called for by the drawdown formula and covered those large DTCs the next day by depositing Hutton "branch reimbursement checks" into the affected branch accounts. This procedure caused the branch's bank to be persistently uncollected on an average ongoing basis, thereby resulting in, in effect, the bank's extension of an interest-free loan to Hutton. Had the local bank been monitoring the account and charging Hutton for its use of uncollected funds (as most banks do and all banks should do), the bank would not have suffered any loss. In any event, the restitution program established pursuant to the plea agreement will ensure that no injured bank will go uncompensated.

(B) Multiple Transfers

The basic cash concentration system described above was vertical -- branch to region to national concentration account. In some instances during the July 1980 - February 1982 time period covered by the Government's charges, however, the branch-to-region-to-headquarters system was altered so that branches drew down other branches before themselves being drawn down by their regions. Thus, instead of Branch A and Branch B both being drawn down by their region in the amounts of, say, $100 and $200, Branch B would draw down Branch A in the amount of $100 and the region would then draw down Branch B in the combined amount of $300.

The purpose of such branch-to-branch transfers, or "multiple transfers", was in many instances to increase and then recapture float caused by clearing delays. If all checks clear in one day, the entire $300 drawdown in the previous example will travel through the system to the national concentration account the day after deposit and, indeed, there will be no difference in effect between the original "vertical" drawdown and the "multiple transfers" just described. But checks do not always clear when they are supposed to, and the multiple transfers increased the potential benefit to Hutton when clearing delays occurred. Although the number of checks in the system does not increase under multiple transfers -- there is still one DTC per branch per day -- the average size of the DTCs increases; in our example, the Branch A DTC is still $100, but the Branch B DTC is now $300 instead of $200. If the Branch A DTC "floats" for a day there is no additional benefit, but if the Branch B DTC "floats", the benefit to the local bank (which Hutton will then "recapture") will be $300 instead of $200. Even if clearing delays are random events, therefore, the increased size of the DTCs in the system increases the average expected float benefit to Hutton, and some locations may well have been selected with an eye toward increasing the likelihood that checks would fail to clear on schedule. Although there were often legitimate business reasons for branch-to-branch transfers,[1] in many cases a principal reason was a desire to find and take advantage of this sort of "float", especially toward the end of 1981 when interest rates rose.

---

[1] These reasons included:

a) Administrative convenience. From time to time DTCs of several branches would be deposited in another branch, which would then be drawn down by the region, thus decreasing the administrative load on the regional cashier. With numerous telephone calls or wires transmitting drawdown information arriving in a brief time period each afternoon, it was a considerable burden for a regional cashier to receive the information, process it, and issue drawdown checks for all the branches in a region every day. The burden was reduced (by being spread around) when some branches concentrated the funds of several other branches before being drawn down by a regional office.

b) Speeding up availability. Sometimes the Company

(Footnote continued on next page)

In theory, multiple transfers should not injure the banks. They are the initial beneficiaries of float, and the Hutton drawdown system recaptured less than all of the float, so the banks may actually benefit to some extent from this activity. For several reasons, however, which are related to availability, some banks may have been hurt in practice.

(Footnote continued from preceding page)

could get better availability on DTCs by taking several small steps rather than one large one. Regional concentration banks might give one-day availability on major banks in neighboring states, but not on smaller banks there, whereas the neighbor-state major banks *would* give one-day availability on the smaller banks. It made sense, therefore, to draw down the smaller banks into the major banks in their own state, which would then be drawn into the regional accounts, so *all* deposits would reach the region in the desired one day.

c) *Slowing down clearing*. In a few cases, because of local peculiarities, DTCs were clearing on the day of deposit. These DTCs thus cleared a day before the customer checks that had been deposited in the branch bank became collected, so the banks of branches whose DTCs cleared on a same-day basis were consistently uncollected. To solve this problem without having to modify the entire drawdown calculation for such branches, the affected branches were drawn down by location other than their own region's concentration account.

d) *Satellite branch offices* (*i.e.*, branch offices geographically close and administratively subordinate to other offices) were frequently drawn down through their main branch.

First, a bank may have assumed that the deposit mix of the Hutton branch consisted almost entirely of customer checks drawn on nearby banks. If, however, a Hutton branch also includes in its deposit a check from another Hutton branch drawn on a bank outside its immediate environs, the branch's bank may not be able to obtain one-day scheduled collection on these checks. If the bank does not realize this, it will be persistently uncollected.[2] Moreover, the Hutton drawdown system -- which assumes one-day availability throughout -- will treat the two-day clearing as float to be recaptured, thereby causing the DTCs to grow larger and increasing the injury to the banks.[3]

Second, increased float results in increased recapture, which in turn results in increased use of branch reimbursement checks (BRCs). The Hutton drawdown system assumes that these BRCs are always given one-day availability. This is a reasonable general assumption, since the BRCs are drawn on major New York banks, and New York is a one-day point from most of the United States, but the assumption is not universally true. When there is not much float, BRCs are generally small and infrequent and erroneous assumptions as to availability are unlikely to matter much in the long run. As float increases, however, this may no longer be true, and the potential for injury to the banks increases.

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[2] The civil injunction in this case accordingly requires disclosure to and agreement by a bank before it may be used as a concentration point.

[3] The DTCs can also grow larger if float occurs over a weekend. Because most banks are closed on Saturday and Sunday, Friday's closing collected balance has a triple effect on the ongoing average, for it is Saturday's and Sunday's as well. The Hutton drawdown system takes this into account by increasing the DTC adjustment factors where weekends are involved.

There was also a third way in which some banks could have been injured by multiple transfers. Some branches combined multiple transfers with excessive drawdowns -- that is, instead of simply adding the incoming DTC to the outgoing one, these branches added more. This resulted in increasing the uncollected balances.

IV. HOW DID IT HAPPEN?

Neither the multiple transfers that were engaged in solely to benefit from float nor the excessive drawdowns were sanctioned Company policy. Both practices became more extensive in late 1981 in response to rising interest rates, and as knowledge about these practices spread. As is common in the industry, the compensation of Hutton branch managers is tied partially to the profitability of their offices, and one of the elements in determining profitability is interest income. During the period of rising interest rates in 1980 and 1981, there was particular sensitivity to the importance of interest income. It appears that in some instances one of the responses on the branch and regional level to incentives to take maximum advantage of all the float in the system was to take advantage of float that was not there.

The Company and its auditors did not detect these deviations because the Company's internal controls were geared towards assuring compliance with the numerous state, federal, and internal regulations that safeguard customer accounts. Those controls have always worked and continue to work well. In retrospect, however, the Company could and should have kept a tighter rein on its internal banking practices to keep them from crossing the dividing line between aggressive and improper.

V. HUTTON'S RESPONSE AND THE FUTURE

Uncovering the Wrongdoing

Multiple transfers came to the attention of senior management as a result of a series of events in late 1981. A multiple transfer of funds in the Middle District of Pennsylvania came to management's attention in December 1981 when it collapsed under its own weight.[4] This multiple transfer activity was immediately shut down. In February 1982, when senior management became concerned that the problem might be more widespread, it initiated an internal investigation, which discovered the existence of other multiple transfer systems. Firm steps described below were taken to shut them down and to prevent their recurrence.

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[4] This Pennsylvania/New York multiple transfer activity functioned for only 6 days in the first half of December

(Footnote continued on next page)

(Footnote continued from preceding page)

1981. Hutton's Wilkes-Barre branch drew down three New York area branches and was itself drawn down by Batavia, New York. Batavia and Strafford, Pennsylvania were drawn down by Fortieth Street (in New York City), which was drawn down by the Atlantic Region concentration account in Rochester.

This multiple transfer was dismantled immediately after an incident on December 11, involving Genesee Country Bank in Batavia, an incident that was symptomatic of a problem that appeared as soon as multiple transfers were started: some of the small banks involved were unable to handle the larger items that were sent through the Company accounts. On Friday, December 11, 1981, Genesee was presented with a large DTC that had been deposited in Republic Bank (the account used by the Fortieth Street branch in New York City). Genesee had Company checks drawn on United Penn Bank in Wilkes-Barre, and it called United Penn to ask whether United Penn had collected funds of $8,000,000 in the Company account. It did not. United Penn did, however, have uncollected funds, represented mainly by Hutton branch reimbursement checks that had been deposited the day before. Genesee thereupon dishonored the DTC presented by Republic, and both Genesee and United Penn subsequently dishonored several other DTCs. Upon learning of these actions, Hutton immediately wired federal funds into both banks -- $20,000,000 to Genesee Country Bank, and $18,800,000 to United Penn. The bank then closed the Company's account.

Some of the excessive drawdowns came to light at about the same time, and persons participating in them were directed to stop. Other excessive drawdowns that had occurred were uncovered as the Government's and Hutton's investigations progressed, but there is no indication of such practices having taken place after February 1982; the controls described below were designed to stop _all_ multiple transfers and _all_ excessive drawdowns.

Corrective Measures

On February 22, 1982, wires were sent to the Regional Vice-Presidents and Operations Managers instructing them where their branches were to be drawn down. The wires required positive acknowledgement by the recipients. _Unauthorized branch-to-branch transfers have not occurred since the first quarter of 1982_.

On May 17, 1982 the Company directed all branch and regional personnel to discontinue making adjustments for "on us" and other good funds deposits and to merely draw the branch checkbooks to zero at the end of each day (_i.e._, proceed according to Table I above). Nationally recognized cash management specialists at the Big Eight accounting firm of Arthur Young & Company were retained to review the branch drawdown procedure and consult with the Company about potential adjustments and/or improvements. As a result of these consultations the DTC calculation procedure was revised in July to eliminate some of the ambiguities in the old procedure and to spell out in a less confusing fashion precisely how the drawdown was to be computed each day.[5] A few months later the procedure was revised again to implement Arthur Young's suggestion that some aspects of the concentration system could make use of wire transfers.

The Company is currently in the process of installing a Branch Information Processing System ("BIPS") in New York and in the Company's 400 branches, at a cost of $42 million. An automated drawdown system is a priority procedure for BIPS and is currently scheduled to be implemented in 75-100 branches that are expected to be on line shortly. This system will serve a great number of functions and will automate branch cashier functions, branch drawdown, and new accounts processing. The system will curb calculation errors and, more in terms of the issues raised in this case, is designed to allow New York to monitor drawdown activity at the branch and regional levels. By automating the drawdown process, BIPS will completely eliminate any faint residual possibility that multiple transfers or excessive drawdowns -- which have not occurred since early 1982 -- could somehow crop up again.

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[5] The Company believes that some of the excessive drawdowns may have begun as a result of calculation mistakes that then became less and less inadvertent.

In addition to these controls, the Company is required by its plea agreement and by the civil injunction to institute certain additional precautionary measures, including instructional seminars to employees and special controls by internal and outside auditors.

APPENDIX

The E. F. Hutton Cash Concentration System

E. F. Hutton is a large, geographically dispersed company, with some 400 branches throughout the United States. There were 300 offices at year end 1981. Each day those branches receive funds, generally in the form of checks, which the Company cannot in turn use effectively -- to pay customers and reduce borrowings -- until the funds are concentrated into centralized accounts in major money-center banks. One aspect of the Company's cash concentration system, therefore, is designed to transfer funds as quickly and efficiently as possible from its branch banks to regional banks and from there to two central accounts, one in New York and one in Los Angeles. While it is in Hutton's interest to transfer the funds quickly, it is in a bank's interest to hold onto the funds as long as possible. Banks earn money -- both as compensation for deposit services and as additional profit -- by investing funds customers leave on deposit with them; the longer the money is left on deposit, the more the bank earns. And because banks do not pay interest on commercial deposits, any time a commercial customer leaves more funds in its account than are necessary to pay for services rendered by the bank, it has given too much to the bank.

Before a bank can invest customer funds, however, those funds must be "collected" -- that is, they must represent actual cash available to the bank and not merely a check that will be, but has not been, collected from another bank. Banks generally keep track of two balances for each account -- the "ledger" balance, which reflects the actual amount of deposits and withdrawals, and the "collected" (or "available") balance, which reflects only those deposited items that have cleared any necessary process of collection. Banks can and often do permit corporate customers to use funds that have not yet been collected, but they charge customers for this service, either by direct fee assessment or by a request that the customer leave additional collected funds on deposit for a period of time to make up for the period in which its collected balance was in deficit.

The function of Hutton's cash concentration system is to move collected balances from outlying locations to centralized corporate concentration accounts, leaving -- on average but not necessarily on any particular day -- sufficient collected balances in the local banks to compensate them for their services to the Company, while avoiding leaving balances so large that the banks receive excess compensation. Generally, Hutton's system works satisfactorily. During the period between July 1, 1980 and February 28, 1982, however, the system

READEX FICHE

was abused and Hutton drew against uncollected balances to a greater extent than certain of its banks expected. The result was that these banks not only were not compensated but, in effect, made interest-free loans to Hutton.

Hutton's approximately 400 domestic branches are organized into nine regions for administrative purposes. Historically, the regions have also served as intermediate cash concentration points between the branches and the main national concentration accounts in Los Angeles and New York.

The two principal cash concentration techniques in use in the United States today are wire transfers and depository transfer checks. Wire transfers, while quick and efficient, are also very costly and can only be used during a portion of the business day. The principal alternative, "depository transfer checks," or DTCs, was the technique used by Hutton. DTCs are checks drawn on one company account and deposited in another. Depository transfer checks from all the branches in a given region were deposited into the region's concentration accounts, and depository transfer checks from all the regional accounts were deposited in one of the two national concentration accounts. Like all checks, the DTCs must clear through the banking system before the funds they represent become collected at the bank in which they are deposited. This process often takes a day or more, with the result that the Company's funds may remain on deposit in the local banks for that period.

In the simplest possible scenario all customers would pay by checks drawn on other banks, and the branches would inform the regional cashier each afternoon of the amount of the day's total deposit at the branch.[6] The regional cashier would then deposit into the regional concentration account a DTC drawn on each branch's bank in the amount of that branch's deposit. Later the same afternoon, the regions in turn would inform Hutton's national cash desk of their total DTC deposit, and DTCs on the regional banks would be deposited into a national account. The next day, all of the customer checks would become collected in the branch banks, just in time to cover the branch DTCs being presented for payment; all of the branch DTCs would become collected in the regional banks in time to cover the regional DTCs; and all of the regional DTCs would become collected in the national concentration account to be used for corporate purposes. The funds would, in effect, flow from the customers' accounts to the national account in a single day. All balances would be drawn out the day they became collected, so Hutton's banks would not have had use of Hutton's funds overnight.

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[6] The accounts in question were used to collect receipts. Payments to customers were generally made out of other, centrally located accounts.

(1) The Effect of "On Us" Checks

The world is not so simple, however. Local Hutton branch deposits may contain cash or wire transfers or, more often, contain a significant portion of customer checks that are written on an account in the same bank as Hutton uses ("on us" checks) and thus do not need to be collected through the banking system. All these items are treated as collected (and thus available to the depositor) immediately on deposit. If all that Hutton did was to deposit DTCs in its regional accounts equal to the amount of its deposits in branch accounts, and those deposits contained (as they normally do) a significant portion of "on us" checks, the effect would be to give branch banks the full use of the funds represented by the "on us" checks until the next day, when the DTC cleared. Those funds however, are Hutton's funds, and it has been -- and is -- Hutton's position that while it pays banks for services rendered, it is otherwise entitled to the benefit derived from the use of its money.

To redress this imbalance, each Hutton branch each day kept track of deposits of cash, "on us" checks and other immediately available funds. Using a formula, the branch calculated a DTC in an amount potentially larger than the actual amount of customer deposits for that day, with the excess related to the proportion of local deposits consisting of immediately available funds. The formula also takes into account a targeted extra amount of collected funds that the Company seeks to keep on deposit to compensate the bank for its services.

For example, if $30 of a branch's $100 deposit consisted of "on us" checks or other immediately available funds, but only $10 in collected funds was needed to compensate the bank for its services, the Hutton branch's DTC for that day would not be $100 (the amount of the total deposit), but rather $120. The bank's collected balance *tonight* would be $30 -- *i.e.*, $20 too much -- but this will be taken care of tomorrow when the DTC is presented for payment: the $20 added to the DTC will ensure that *tomorrow's* collected balance will be $20 lower than it would otherwise have been. The system proceeds day by day, adjusting tomorrow's collected balance to make up for today's excess or deficit.

Writing a DTC for more than the amount deposited raises the issue of whether there will be funds on deposit to cover the DTC when it is presented for payment the next day. In most instances the day 2 customer deposits will be sufficient to cover the day 1 DTC when it is presented; if those deposits are not sufficient, however, Hutton deposits one of its own checks drawn on a special bank account in New York into the branch is account. The checks used for this purpose were known as "branch reimbursement checks" or "BRCs." Writing a DTC in excess of the day's total deposit may well result in drawing on uncollected funds in order to compensate for a previous excess collected balance, but the BRC mechanism ensures that (clerical errors aside) there will never be an "overdraft", i.e., Hutton will not attempt to draw out of a bank more than has actually been deposited there.

Thus, suppose a Hutton branch takes in $100,000 a day in customer receipts, consisting of $25,000 in wire transfers and "on us" checks and $75,000 in checks written on other banks. Suppose further that an average daily collected balance of $10,000 is considered necessary to compensate the bank for its services, and suppose finally that all checks (other than the immediately available "on us" checks) clear in one day. Then the Hutton branch's account at its bank would show a total deposit on Monday of $100,000, of which $25,000 would be treated as "collected." The remaining $75,000 would not be treated as collected until Tuesday, when the checks constituting that portion of the deposit would clear. Similarly, $25,000 of the branch's $100,000 Tuesday deposit will be treated as collected on Tuesday and $75,000 as collected on Wednesday, and so on throughout the week.

In the simplest form of DTC concentration system, Hutton would each day write a DTC on the branch's account in the amount of the day's total deposit at the branch (here, $100,000 each day) and deposit that DTC in one of its concentration accounts. The DTC would clear through the banking system and be presented for payment to the branch's bank the next day. This would effect the transfer of funds from the branch's account to the concentration account, as set forth in Table I.

From Hutton's point of view, the problem with this simple system is that although funds are transferred efficiently the local bank is being overcompensated for its services. That is, the collected balance at the local bank is $25,000 each night, which is $15,000 more than needed to compensate the bank. The bank, in short, is making excess profits with Hutton's money. To prevent this, the Hutton concentration system was designed to adjust the amount of each day's DTC to reflect that day's immediately available deposits and thereby come closer to targeted bank compensation. Using this example, a DTC of $115,000 would be written and deposited in the concentration account on the first night ($100,000 thereafter) in order to leave that bank $10,000 in cash each night. The way the system would have worked in practice on the facts of the example in Table I is shown in Table II.

Table I

	Bank Balances ($000)			
	Branch Account		Concentration Account	
Activity	Ledger	Collected	Ledger	Collected
Monday				
Opening Balance	0	0	0	0
Customer Deposits	100	25	0	0
Monday's DTC	0	0	100	0
Closing balance	100	25	100	0
(Overnight, all Monday checks become collected)		75 100		100 100
Tuesday				
Opening Balance	100	100	100	100
Customer Deposits	100	25	0	0
Monday's DTC clears	(100)	(100)	0	0
Tuesday's DTC	0	0	100	0
Closing Balance	100	25	200	100
(Overnight, all Tuesday checks become collected)		75 100		100 200
Wednesday				
Opening Balance	100	100	200	200
Customer Deposits	100	25	0	0
Tuesday's DTC clears	(100)	(100)	0	0
Wednesday's DTC	0	0	100	0
Closing Balance	100	25	300	200
(Overnight, all Wednesday checks become collected)		75 100		100 300
Thursday				
Opening Balance	100	100	300	300
Customer Deposits	100	25	0	0
Wednesday's DTC clears	(100)	(100)	0	0
Thursday's DTC	0	0	100	0
Closing Balance	100	25	400	300

Table II

Activity	Bank Balances ($000) Branch Account Ledger	 Collected	 Concentration Account Ledger	 Collected
Monday				
Opening Balance	0	0	0	0
Customer Deposits	100	25	0	0
Monday's DTC	0	0	115	0
Closing balance	100	25	115	0
(Overnight, all Monday checks become collected)		75 100		115 115
Tuesday				
Opening Balance	100	100	115	115
Customer Deposits	100	25	0	0
Monday's DTC clears	(115)	(115)	0	0
Tuesday's DTC	0	0	100	0
Closing Balance	85	10	215	115
(Overnight, all Tuesday checks become collected)		75 85		100 215
Wednesday				
Opening Balance	85	85	215	215
Customer Deposits	100	25	0	0
Tuesday's DTC clears	(100)	(100)	0	0
Wednesday's DTC	0	0	100	0
Closing Balance	85	10	315	215
(Overnight, all Wednesday checks become collected)		75 85		100 315
Thursday				
Opening Balance	85	85	315	315
Customer Deposits	100	25	0	0
Wednesday's DTC clears	(100)	(100)	0	0
Thursday's DTC	0	0	100	0
Closing Balance	85	10	415	315

As Table II shows, the adjustment to the Monday DTC is sufficient to reduce closing collected balances (after the first day) to the targeted level of $10,000. The adjustment may very well result in Hutton's drawing on uncollected funds. For example, in Table II, if none of the Tuesday customer deposit consisted of immediately available funds, then the closing collected balance at the local bank would not be plus $10,000 but would instead be minus $15,000. The results for the entire week would then be as given in Table III. In Table III, the average closing collected balance (after Monday) is plus $10,000; Wednesday's balance of plus $35,000 makes up for Tuesday's $15,000 deficit. Table IV shows the result if there were no customer deposits at all on Tuesday, in which case a Hutton check (a branch reimbursement check, or "BRC") would have to be deposited in the branch account to prevent Monday's DTC from causing an overdraft. Once again, the average closing collected balance for Tuesday, Wednesday and Thursday is plus $10,000, although the actual balance on any one day varied.

Table III

	Bank Balances ($000)			
	Branch Account		Concentration Account	
Activity	Ledger	Collected	Ledger	Collected
Monday				
Opening Balance	0	0	0	0
Customer Deposits	100	25	0	0
Monday's DTC	0	0	115	0
Closing balance	100	25	115	0
(Overnight, all Monday checks become collected)		75 100		115 115
Tuesday				
Opening Balance	100	100	115	115
Customer Deposits	100	0	0	0
Monday's DTC clears	(115)	(115)	0	0
Tuesday's DTC	0	0	75	0
Closing Balance	85	(15)	190	115
(Overnight, all Tuesday checks become collected)		100 85		75 190
Wednesday				
Opening Balance	85	85	190	190
Customer Deposits	100	25	0	0
Tuesday's DTC clears	(75)	(75)	0	0
Wednesday's DTC	0	0	125	0
Closing Balance	110	35	315	190
(Overnight, all Wednesday checks become collected)		75 110		125 315
Thursday				
Opening Balance	110	110	315	315
Customer Deposits	100	25	0	0
Wednesday's DTC clears	(125)	(125)	0	0
Thursday's DTC	0	0	100	0
Closing Balance	85	10	415	315

Table IV

Activity	Bank Balances ($000) Branch Account Ledger	 Collected	 Concentration Account Ledger	 Collected
Monday				
Opening Balance	0	0	0	0
Customer Deposits	100	25	0	0
Monday's DTC	0	0	115	0
Closing balance	100	25	115	0
(Overnight, all Monday checks become collected)		75 100		115 115
Tuesday				
Opening Balance	100	100	115	115
Customer Deposits	0	0	0	0
Hutton Check (BRC)	15	0	0	0
Monday's DTC clears	(115)	(115)	0	0
Tuesday's DTC	0	0	0	0
Closing Balance	0	(15)	115	115
(Overnight, all Tuesday checks become collected)		15 0		
Wednesday				
Opening Balance	0	0	115	115
Customer Deposits	100	25	0	0
Tuesday's BRC clears	0	0	(15)*	(15)*
Tuesday's DTC clears	0	0	0	0
Wednesday's DTC	0	0	105	0
Closing Balance	100	25	205	100
(Overnight, all Wednesday checks become collected)		75 100		105 205
Thursday				
Opening Balance	100	100	205	205
Customer Deposits	100	25	0	0
Wednesday's DTC clears	(105)	(105)	0	0
Thursday's DTC	0	0	110	0
Closing Balance	95	20	315	205

The Hutton check deposited into the branch account was not actually drawn on the concentration account but rather on a separate account maintained for the sole purpose of issuing these "branch reimbursement checks." For simplicity, in order to show the net effect on Hutton, the concentration account and the branch reimbursement account are combined in this Table.

(2) Effects of "Float"

Deposits of immediately available funds are not the only way banks can enjoy excess collected balances. Such balances can also be created by the "float" that results from delays inherent in the check clearing system.

"Float" arises from the occasional differences between the time in which a check is scheduled to clear and the time in which the check actually clears. For more than 30 years the Federal Reserve System has been committed to clearing any check drawn on one member bank and deposited in another within two days, and many checks clear in one day. Many banks are also members of local clearing houses, at which they can clear checks drawn on one another within one day, and clearing can also occur through networks of correspondent banks. Banks make studies of how long it takes checks drawn on other specific banks to clear, and they will often treat a deposited item as "collected funds" when the item is scheduled to clear, rather than when it actually clears. Thus, each of the twelve Federal Reserve Banks can usually clear a check drawn on a member bank within its district in one day if the presenting bank[7] gets the check to the [illegible] by a certain deadline, and the

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[7] The "presenting bank" is the one seeking to collect the check; it may be the bank in which the item was originally deposited or a correspondent of that bank.

Fed will therefore give credit on such an item to the presenting bank in one day even if the Fed is subsequently unable to present the item to the bank on which it is drawn within the scheduled time frame. Such a clearing failure can result from many causes -- weather or other transportation delays, equipment breakdowns, checks that are smudged or wrinkled so the magnetic ink line at the bottom cannot be machine read, and so on. Regardless of the cause, however, the effect of a clearing delay is always the same: the funds represented by the check are treated as "collected" in two separate locations at once.

Suppose, for example, that a $100 Hutton branch DTC is deposited in a regional concentration account in the same Federal Reserve District as the bank on which it is drawn. The regional bank will get the DTC to the Fed that night and receive credit for it the next day, since the Fed knows it is scheduled to collect the check then. If the roads are icy, however, the check may be a day late getting to the branch's bank -- which means that the funds that were supposed to be pulled out of the local bank by the DTC will stay on deposit an extra day. This would not affect the regional bank; during the July 1980 - February 1982 time frame the Fed did not make adjustments when items failed to clear.[8] But the local bank will have an extra day's use of the funds as a result of this "float," thereby obtaining an extra day's interest benefit.

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[8] Under the impetus of the Monetary Control Act of 1980 the Fed began making such backcharges in 1983, in addition to vastly improving its check clearing system to substantially reduce this "float."

It was (and is) Hutton's view that it is entitled to the benefit of any float on checks Hutton deposited. The Hutton drawdown system therefore had a mechanism to "recapture" float from the branch banks when Hutton DTCs failed to clear on time. This mechanism operated in much the same way as did the DTC adjustment for immediately available funds: when float (and thus an excess collected balance at the local bank) was detected, the size of a subsequent DTC was increased to make the local bank sufficiently uncollected so that the average collected balance would come close to the target compensating balance.

Mr. **Rae**. To the degree of intelligence we had on that day was the result of preparation of seeing documents submitted to the grand jury in the course of a 3-year investigation and furnishing of a great deal of data.

To the extent whether that was appropriate, but as a result on the basis of information then known on the basis of the grand jury investigation, it came to our attention in the course of cooperating with the U.S. attorney in making the inquiry.

Mr. **Morrison**. I am sorry. Maybe it is me. But I didn't understand what you just said.

Mr. **Rae**. You are asking——

Mr. **Morrison**. In May of this year, you said in early 1982 the company had done—I don't mean you personally—the company had said that it had done an internal investigation in 1982. Now, when I just asked you about that you said there was no investigation because you didn't want to obstruct the grand jury's investigation.

I would like to square those.

Mr. **Rae**. It is a matter of terminology and chronology. I will tell you what occurred.

Mr. **Morrison**. Tell me what happened in 1982.

Mr. **Rae**. In February 1982, these matters came to the attention of senior management as a result of meetings certain of us had with representatives of the New York State Banking Commission and Federal Reserve Board.

On the very day that the meeting was held, or at the conclusion, we retained Cahill & Gordon. Because of concerns expressed to us, we felt a concern to launch an inquiry. That same month, and not oo many days after that meeting, it became evident to us at least some of our offices were engaged in so-called multiple drawdowns.

Those practices were terminated. We continued to look into the matter and get intelligence with respect to how the drawdown system was working and concluded that, secondly, we saw some evidence about an excessive drawdown.

At that point we decided to close down our cash management plan, start drawing checks only on the collected balance and employ an outside consultant, Arthur Young, to come into the company and assist us in examining and imposing and implementing a cash mobilization program which hopefully would be beyond attack by anyone, would be an appropriate legal type of system, and that was done.

Shortly thereafter, and this is in May 1982, the grand jury convened in the middle district of Pennsylvania. From that point on, our main resources obviously were utilized in cooperating with the U.S. Government in that investigation.

Mr. **Morrison**. So, in other words, you did a little preliminary checking around, found some things that were of concern, ordered them stopped and then hired Arthur Young to design a new system.

Mr. **Rae**. We stopped the violating practice and we brought in Arthur Young, and we did not resume that system until we were satisfied it was perfectly appropriate. And the remainder of the time obviously was the conduct of the grand jury investigation; cooperating with that investigation.

Mr. **Morrison**. Did you tell Arthur Young you were under criminal investigation, there was a threat of criminal prosecution with respect to those practices?

Mr. **Rae**. They were aware of it, yes.

Mr. **Morrison**. When did you tell them? Before they were hired or after they were hired?

Mr. **Rae**. I am sure in the course of the meetings they were told to a degree our practices were under study.

Mr. **Morrison**. Don't tell me what you think Cahill did. You are not Cahill.

If you don't know, tell me you don't know.

Mr. **Rae**. If you want every conversation with them, I wasn't present obviously.

Mr. **Morrison**. It isn't useful for you to speculate about what might have happened. I understand we are somewhat less formal here than we are in a courtroom, but if you tell us you think something went on you are not telling us anything.

As far as your own personal knowledge or documents you received, when was Arthur Young informed there was a serious criminal investigation about these overdrafting practices?

Mr. **Rae**. I think shortly—or at the time they were retained, Mr. Morrison.

Mr. **Morrison**. At any time from when you say these practices were begun, in 1978, or some date like that—is that the date? This overdrafting practice or this cash management—

Mr. **Rae**. Yes; it was first designed by Mr. Bill Sullivan—it is my recollection he came in 1976 or 1977.

Mr. **Morrison**. When this was being designed, were you or any of your staff ever asked for a legal opinion about the propriety and legality of this?

Mr. **Rae**. No; we were not, to the best of my knowledge. I wasn't.

Mr. **Morrison**. Ever? You were never asked for that?

Mr. **Rae**. As I have gone through the past testimony, my only involvement or discussion in this area occurred in February or March 1980 in connection with the Arthur Andersen discussion, which I previously testified.

Mr. **Morrison**. And when you learned at that time, you declined, for whatever reason—you said because you didn't think it was worth the time—you declined to write a formal opinion?

Mr. **Rae**. It was worth my time to sit and listen to the dissertation made by Mr. Sullivan describing what E.F. Hutton was doing. I was in the company of our outside auditors listening to that, and it resulted in an adequate return.

There was no suggestion of excesses in that system—and today I don't believe there was any excesses in that system he was describing. They appeared perfectly appropriate. And it was totally different than the case they were describing that occurred in California.

There was no excessive drawdowns encompassed in Mr. Sullivan's plan, and there was no indication that any such activities ever had taken place, Mr. Morrison.

Mr. **Morrison**. And it was your legal opinion at that time there was no illegality in what was described?

Mr. **Rae**. On the basis he had an understanding, we had the intent to pay the obligation, and on the fact every month they were compensated, no, I did not believe it constituted illegal activity.

Mr. **Morrison**. Were you aware of the Dipple letter I asked you about?

Mr. **Rae**. What was the date?

Mr. **Morrison**. 1960.

Mr. **Rae**. What month in 1960?

May I see that, Mr. Morrison?

Mr. **Morrison**. Sure; I would be glad to show it to you.

Mr. **Rae**. This is dated November 1981.

Mr. **Morrison**. I am sorry. You are right. My mistake.

Mr. **Rae**. This conversation was in February 1980, March 1980.

Mr. **Morrison**. My mistake. Were you aware of this letter in 1981?

Mr. **Rae**. No; I would not have been. No; my first knowledge of seeing these instruments—I couldn't say every document I have ever seen at E.F. Hutton.

My knowledge would have been as a result of a subpoena.

Mr. **Morrison**. In other words, when some companies make a claim for $200,000 against E.F. Hutton, that is pocket change?

Mr. **Rae**. In most instances, anybody who has a claim comes into my legal department. During that period not a single bank came to my department, or wrote, or communicated with my department with respect to a claim.

In most cases if someone had trouble with a local banker, they may have sat down and resolved their problem. To my knowledge, there has never been a single litigation or claim filed with my department by any bank alleging misconduct in this area.

Mr. **Morrison**. The subsequent practices, the ones that were implemented as a result of the Arthur Young recommendations, did you review those independently for your legal opinion?

Mr. **Rae**. Yes; I viewed them, outside counsel viewed them. I think they were viewed by both Arthur Andersen and Arthur Young.

Mr. **Morrison**. Did you write any opinions on their propriety?

Mr. **Rae**. No; we did not. We discussed them at length. We went through the formulas, and we obviously were dealing with what we thought to be the most prestigious organization in the country with respect to designed corporate management practice for major corporations.

Their team consisted of former—as I recall, an attorney in the Federal Reserve System was part of the team that the organization furnished us. They had legal expertise basically in connection with their team. And he knew far more, obviously, than I or most other attorneys there.

Mr. **Morrison**. If you could just state for me now your legal opinion about where the line is where these cash management practices move from being legal to illegal—what are the critical criteria that determine the line?

Mr. **Rae**. Today, Mr. Morrison, I think there is a new legal criteria. Obviously, E.F. Hutton will not do any overdrafting as any part of a cash mobilization practice without a written consent of the bank contract pursuant to the injunctive decree we have sent to every bank at our discretion.

Mr. **Morrison**. I understand that is where you are now. That is what you are bound by because you have signed a consent decree. What is your legal opinion with respect to what the line is as far as a matter of law, not as a matter of a consent decree but as a matter of existing law?

What is the line between what kind of overdrafting is legal and what kind of overdrafting is illegal?

Mr. **Rae**. I think, obviously, excessive overdrafting has been clearly identified. It is a fine line——

Mr. **Morrison**. What makes overdrafting excessive?

Mr. **Rae**. Because the result is obviously it could result in maintaining a day loan—it does not leave the bank any adequate return.

Mr. **Morrison**. Isn't excessive overdrafting to overdraft in connection with your agreement with the bank?

Mr. **Rae**. It depends on your agreement with the bank.

Mr. **Morrison**. Isn't overdrafting of any kind excessive if it is not in accordance with your agreement with the bank, if it is contrary to your agreement——

Mr. **Rae**. Yes; if there is a total lack of communication. It is our feeling many banks were aware of what Hutton was doing and agreed to it. It is a question, the relationship may differ with every bank.

I think it is very difficult to put awareness—where is the acceptable and where is the questionable?

Mr. **Morrison**. I find it shocking you have trouble drawing this line after all of this, frankly.

Mr. **Rae**. I don't today.

Mr. **Morrison**. You can draw it for E.F. Hutton but you can't give us any substance of understanding whether the rules of the game are well enough designed so this isn't happening all across——

Mr. **Rae**. I think corporate legal counsel throughout America will be reading the E.F. Hutton plea to the criminal information and, more importantly, the injunctive decree and the procedures laid out in that decree.

I think the Department of Justice stated it was a message to corporate America. Our message is we will have written agreements with each and every bank and they will have a full understanding of our procedures in writing.

Mr. **Morrison**. Do you feel that is an appropriate rule of law in general?

Mr. **Rae**. After what we have gone through, if we had this available throughout that entire period we wouldn't be here today. I think it is a preferable way to go.

As a result, it is a safe, conservative route, and if Hutton—we certainly are going to be under that standard, and I assume others will follow us.

Mr. **Morrison**. I have one other document I would like to discuss with you. It is a document dated January 18, 1985, which is known as record retention from Jack Lees, and it discusses banking records for the period January 1, 1981, through December 31, 1982, stored at the Pasadena Moving & Storage Warehouse in Los Angeles.

Do we now have these documents discussed in this memo?

I would like to know if you would take a look at it.

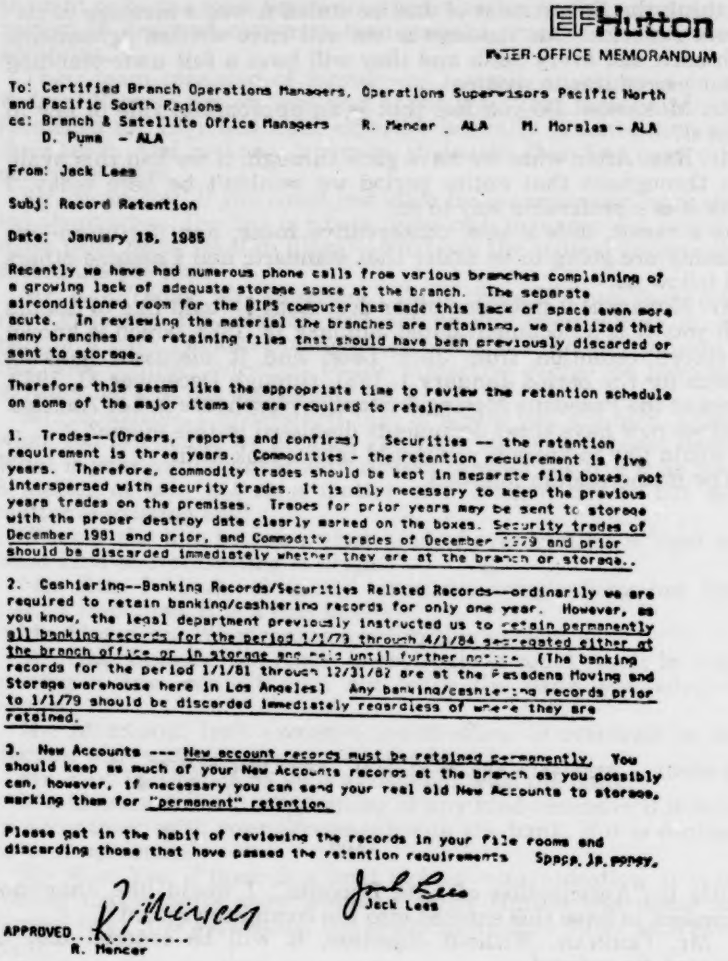
[The memorandum follows:]

title is "Anticipation of Late Deposits." I would like unanimous consent to have this entered into the committee record.

Mr. **Feighan**. Without objection, it will be entered into the record. So ordered.

[The information follows:]

NOTICE: If the film image below is less clear than this notice, it is due to the quality of the document being filmed.



EFHutton
INTER-OFFICE MEMORANDUM

To: Certified Branch Operations Managers, Operations Supervisors Pacific North and Pacific South Regions
cc: Branch & Satellite Office Managers R. Mencer - ALA M. Morales - ALA
D. Puma - ALA

From: Jack Lees

Subj: Record Retention

Date: January 18, 1985

Recently we have had numerous phone calls from various branches complaining of a growing lack of adequate storage space at the branch. The separate airconditioned room for the BIPS computer has made this lack of space even more acute. In reviewing the material the branches are retaining, we realized that many branches are retaining files that should have been previously discarded or sent to storage.

Therefore this seems like the appropriate time to review the retention schedule on some of the major items we are required to retain----

1. Trades--(Orders, reports and confirms) Securities — the retention requirement is three years. Commodities - the retention requirement is five years. Therefore, commodity trades should be kept in separate file boxes, not interspersed with security trades. It is only necessary to keep the previous years trades on the premises. Trades for prior years may be sent to storage with the proper destroy date clearly marked on the boxes. Security trades of December 1981 and prior, and Commodity trades of December 1979 and prior should be discarded immediately whether they are at the branch or storage..

2. Cashiering--Banking Records/Securities Related Records--ordinarily we are required to retain banking/cashiering records for only one year. However, as you know, the legal department previously instructed us to retain permanently all banking records for the period 1/1/79 through 4/1/84 segregated either at the branch office or in storage and held until further notice. (The banking records for the period 1/1/81 through 12/31/82 are at the Pasadena Moving and Storage warehouse here in Los Angeles) Any banking/cashiering records prior to 1/1/79 should be discarded immediately regardless of where they are retained.

3. New Accounts --- New account records must be retained permanently. You should keep as much of your New Accounts records at the branch as you possibly can, however, if necessary you can send your real old New Accounts to storage, marking them for "permanent" retention.

Please get in the habit of reviewing the records in your file rooms and discarding those that have passed the retention requirements. Space is money.

Jack Lees
Jack Lees

APPROVED..R. Mencer..........
R. Mencer

Mr. **Rae**. I know the identity of the document, but let me look. I have never seen the memo before. Are you asking the question—to the degree I have requested documents as far as notes or the subpoena that the House committee wants now, yes, they are being furnished wherever they were previously assembled or held.

Much of this appears to refer—at least under paragraph 2, to cashiering records, which would be the daily blotters, the ledgers, the drawdown sheets, which we are holding for you in segregated boxes in the regions.

Mr. **Morrison**. I would like to introduce this into the record and just state that this is an example of how these records that are already assembled sitting somewhere raise questions about whether everything has been applied, and is just another matter for you and Mr. Roman to check, along with Mr. Christopher, to make sure we are not missing anything that is within the scope and obviously within the discussions previously with the chairman——

Mr. **Rae**. As I stated earlier, we have an inventory of some 10,932 boxes containing cashiering type of information that we have held—they are segregated and sitting, awaiting instructions, in various physical locations.

Mr. **Morrison**. I want to thank you, Mr. Rae.

Thank you, Mr. Christopher. The hearing will be adjourned.

Mr. **Christopher**. Could I raise a procedural question?

Mr. **Morrison**. Certainly.

Mr. **Christopher**. I wonder if there would be a way we could get an expedited copy of the transcript. A number of requests have been made. I am told we are still awaiting the June 19 transcript, and I gather from the reporter there is some technical reasons why he can't comply with our request to furnish one at our request.

Could you be of any help?

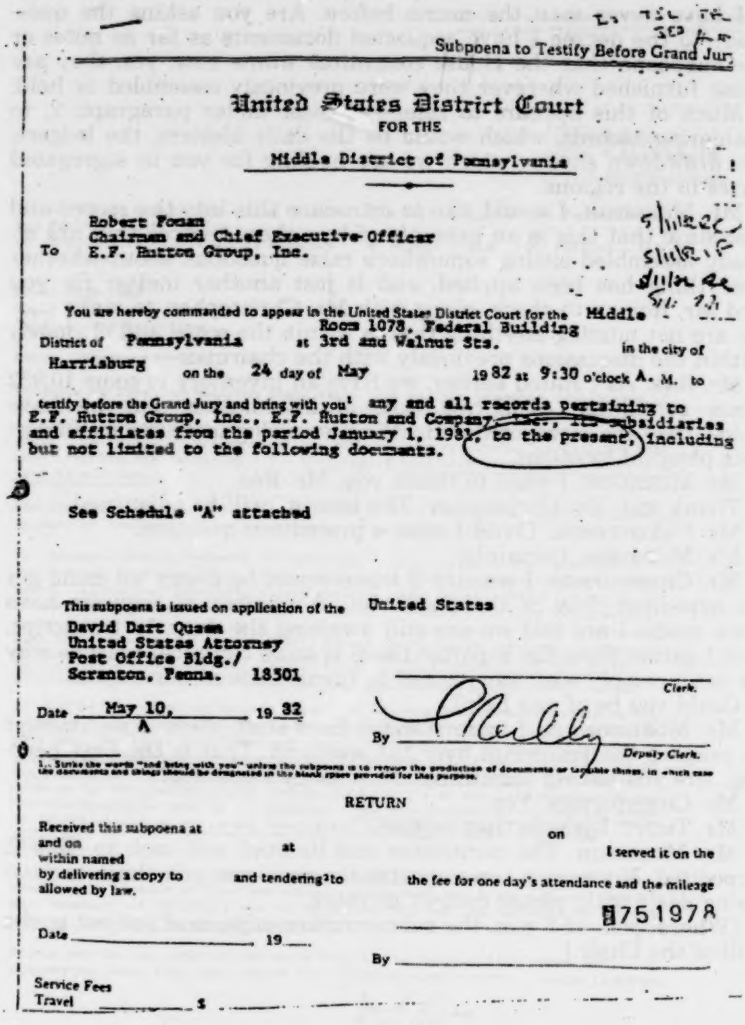
Mr. **Morrison**. As I understand it from staff, there is an attempt to prepare the transcript over the weekend. That is the first hearing. Are you asking something about today's hearing?

Mr. **Christopher**. Yes.

Mr. **Trott**. I join in that request.

Mr. **Morrison**. The committee and its staff will seek to have it expedited. If you run across particular problems you think are not being dealt with, please contact us there.

[Whereupon, at 2 p.m. the subcommittee adjourned subject to the call of the Chair.]



Subpoena to Testify Before Grand Jur

United States District Court
FOR THE
Middle District of Pennsylvania

5/11/82 CC
5/11/82 F

To Robert Foman
Chairman and Chief Executive Officer
E.F. Hutton Group, Inc.

You are hereby commanded to appear in the United States District Court for the Middle District of Pennsylvania at Room 1078, Federal Building 3rd and Walnut Sts. in the city of Harrisburg on the 24 day of May 1982 at 9:30 o'clock A. M. to testify before the Grand Jury and bring with you[1] any and all records pertaining to E.F. Hutton Group, Inc., E.F. Hutton and Company, ~~Inc., its~~ subsidiaries and affiliates from the period January 1, 1981, to the present, including but not limited to the following documents.

See Schedule "A" attached

This subpoena is issued on application of the United States

David Dart Queen
United States Attorney
Post Office Bldg./
Scranton, Penna. 18501

Date May 10, 1982

Clerk.

By Kelly
Deputy Clerk.

---

[1] Strike the words "and bring with you" unless the subpoena is to require the production of documents or tangible things, in which case the documents and things should be designated in the blank space provided for that purpose.

RETURN

Received this subpoena at on
and on at I served it on the
within named
by delivering a copy to and tendering[2] to the fee for one day's attendance and the mileage allowed by law.

8751978

Date 19

By

Service Fees
Travel $

SCHEDULE "A"

1. General ledgers.
2. General journals.
3. Cash disbursements journals.
4. Cash receipts journals.
5. Vouchers.
6. Paid bills.
7. Invoices.
8. Billings.
9. Bank statements.
10. Cancelled checks and check stubs.
11. Payroll records.
12. Contracts and copies of contracts.
13. Sub-contracting agreements and purchase orders.
14. Records of equipment rental and leasing.
15. Financial statements.
16. Bank deposit tickets.
17. Retained copies of income tax returns.
18. Retained copies of payroll tax returns.
19. Purchase journals.
20. Accounts payable ledgers.
21. Accounts receivable ledgers.
22. Stock transfer book.
23. Corporate minutes.
24. Corporate charter.
25. Telephone Company statement of calls and telegrams.
26. Architectural and engineering plans, drawings and specifications.

751979

27. Shop drawings.

28. Records of permit and licence fees.

29. Requisitions by separate subcontractors and trade payment breakdowns.

30. All other requisitions, invoices and estimates.

31. Bids, solicitations to bids and worksheets prepared in connection therewith.

32. Records of payment for all materials, supplies and equipment rentals.

33. Delivery tickets.

34. Construction cost estimates.

35. Bar charts and other progress schedules.

36. Written communications or records of oral communications with subcontractors, vendors, suppliers, architects, public officials and authorities and public utilities.

37. All memoranda, intra-office or otherwise: notes, formal and informal; and all correspondence.

Subpoena to Testify Before Grand Jury

United States District Court

FOR THE

MIDDLE DISTRICT OF PENNSYLVANIA

To **Mary Anne Cardamone**
E.F. Hutton and Company, Inc.
Bank Reconciliation Department
32nd Floor - 1 Battery Park Plaza
New York, New York

5/11/82 EC
5/11/82 EF
5/11/82 RL
5/11 73

You are hereby commanded to appear in the United States District Court for the **Middle** District of **Pennsylvania** at **Room 1078, Federal Building 3rd and Walnut Sts.** in the city of **Harrisburg** on the **24** day of **May** 19**82** at **9:30** o'clock **A.** M. to testify before the Grand Jury and bring with you[1]

SEE attached Schedule "A"

This subpoena is issued on application of the **United States**

David Dart Queen
United States Attorney
Post Office Bldg.
Scranton, Penna. 18501

Clerk.

Date **May 10,** 19**82**

By C Reilly
Deputy Clerk.

---

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RETURN

Received this subpoena at on
and on at I served it on the
within named
by delivering a copy to and tendering[2] to the fee for one day's attendance and the mileage
allowed by law.

751981

Date ______________ 19___

By ______________

Service Fees

SCHEDULE "A"

1) a listing of all checking accounts, listed by bank, bank account number, account opening and closing dates, in the name of E.F. Hutton and Company, Inc., whether jointly or individually held, whether relating to the home or field offices;

2) bank reconciliation records for all E.F. Hutton and Company, Inc. bank checking accounts, which reconciliation records are maintained at the E.F. Hutton and Company, Inc., home office and each E.F. Hutton and Company, Inc. Branch Office;

3) for the accounts previously described in paragraph 1 above, any and all cancelled checks, excluding stockholder dividend checks and employee payroll checks;

4) any and all checking account deposit slips, for the accounts previously described in paragraph 1 above, excluding stockholder dividend checks and employee payroll checks;

5) for the accounts previously described in paragraph 1 above, any and all check stubs, excluding stockholder dividend checks and employee payroll checks;

6) debit and credit memoranda;

7) original computer tapes maintained for all bank accounts previously described in paragraph 1 above;

8) copies of computer runs related to bank accounts previously described in paragraph 1 above;

9) reports, correspondence and memoranda on banking activity relating to the accounts described in paragraph 1 above;

10) documents, correspondence and memoranda relating to the transfer of funds from one account (previously described in paragraph 1, above) to another;

11) corporate minutes or resolutions relating to the bank accounts previously described in paragraph 1 above;

12) signature cards relating to any of the accounts set forth in paragraph 1 above;

13) contracts with any computer company or with any subsidiary or affiliate providing computer services;

8751982

Covering the period from January 1, 1981, to the present.

Hutton - F

Subpoena to Testify Before Grand Jury

United States District Court
FOR THE
Middle District of Pennsylvania

To Michael P. Castellano
Senior Vice-President & Comptroller
E.F. Hutton & Co., Inc.
1 Battery Park Plaza
New York, New York

You are hereby commanded to appear in the United States District Court for the Middle District of Pennsylvania at Room 1078, Federal Building, Third and Walnut Sts. in the city of Harrisburg on the 24 day of May 1982 at 9:30 o'clock A. M. to testify before the Grand Jury and bring with you[1]

See Attached Schedule "A"

This subpoena is issued on application of the United States

David Dart Queen
United States Attorney
Scranton, Penna. 18501

Date May 10, 1982

Clerk.

By Reilly
Deputy Clerk.

---

[1] Strike the words "and bring with you" unless the subpoena is to require the production of documents or tangible things, in which case the documents and things should be designated in the blank space provided for that purpose.

RETURN

Received this subpoena at on
and on at I served it on the
within named
by delivering a copy to and tendering[2] to the fee for one day's attendance and the mileage
allowed by law.

Date ____________ 19__

By ____________

SCHEDULE "A"

1) a listing of all checking accounts, listed by bank, bank account number, account opening and closing dates, in the name of E.F. Hutton and Company, Inc., whether jointly or individually held, whether relating to the home or field offices;

2) bank reconciliation records for all E.F. Hutton and Company, Inc. bank checking accounts, which reconciliation records are maintained at the E.F. Hutton and Company, Inc., home office and each E.F. Hutton and Company, Inc. Branch Office;

3) for the accounts previously described in paragraph 1 above, any and all cancelled checks, excluding stockholder dividend checks and employee payroll checks;

4) any and all checking account deposit slips, for the accounts previously described in paragraph 1 above, excluding stockholder dividend checks and employee payroll checks;

5) for the accounts previously described in paragraph 1 above, any and all check stubs, excluding stockholder dividend checks and employee payroll checks;

6) debit and credit memoranda;

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8) copies of computer runs related to bank accounts previously described in paragraph 1 above;

9) reports, correspondence and memoranda on banking activity relating to the accounts described in paragraph 1 above;

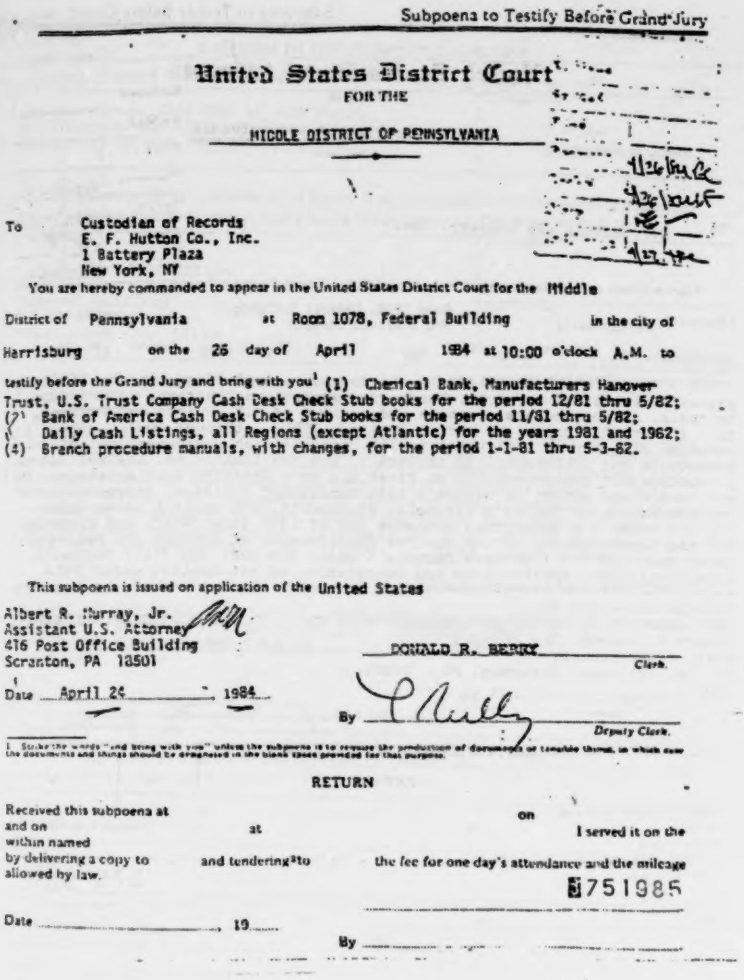
10) documents, correspondence and memoranda relating to the transfer of funds from one account (previously described in paragraph 1, above) to another;

11) corporate minutes or resolutions relating to the bank accounts previously described in paragraph 1 above;

12) signature cards relating to any of the accounts set forth in paragraph 1 above;

13) contracts with any computer company or with any subsidiary or affiliate providing computer services;

Covering the period from January 1, 1982, to the present.



Subpoena to Testify Before Grand Jury

United States District Court

FOR THE

MIDDLE DISTRICT OF PENNSYLVANIA

4/26/84

4/27/84

To
Custodian of Records
E. F. Hutton Co., Inc.
1 Battery Plaza
New York, NY

You are hereby commanded to appear in the United States District Court for the Middle District of Pennsylvania at Room 1078, Federal Building in the city of Harrisburg on the 26 day of April 1984 at 10:00 o'clock A.M. to testify before the Grand Jury and bring with you[1] (1) Chemical Bank, Manufacturers Hanover Trust, U.S. Trust Company Cash Desk Check Stub books for the period 12/81 thru 5/82;
(2) Bank of America Cash Desk Check Stub books for the period 11/81 thru 5/82;
(3) Daily Cash Listings, all Regions (except Atlantic) for the years 1981 and 1982;
(4) Branch procedure manuals, with changes, for the period 1-1-81 thru 5-3-82.

This subpoena is issued on application of the United States

Albert R. Murray, Jr.
Assistant U.S. Attorney
416 Post Office Building
Scranton, PA 18501

Date April 24, 1984

DONALD R. BERRY
Clerk.

By
Deputy Clerk.

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[1] Strike the words "and bring with you" unless the subpoena is to require the production of documents or tangible things, in which case the documents and things should be designated in the blank space provided for that purpose.

RETURN

Received this subpoena at on
and on at I served it on the
within named
by delivering a copy to and tendering[2] to the fee for one day's attendance and the mileage allowed by law.

751985

Date , 19

By

Subpoena to Testify Before Grand Jury

United States District Court

FOR THE

Middle District of Pennsylvania

By Hand
By Mail
In Charge

To E.F. Hutton and Company, Inc.

You are hereby commanded to appear in the United States District Court for the Middle

District of Pennsylvania at Room 1078, Federal Building 3rd & Walnut Streets in the city of

Harrisburg, PA on the 23rd day of May 1984 at 9:30 o'clock A.M. to

testify before the Grand Jury and bring with you[1] all documents including, but not limited to, all writings of any type, kind, or descriptions, letters, memorandum, journals, notes, ledgers, reports and reviews of E.F. Hutton and Company, Inc. ("Hutton") during the period January 1, 1979 through April 1, 1984 relating directly or indirectly to (i) Hutton's cash management policies, procedures and implementation including, but not limited to, its policies, procedures and implementation on float and over drafting bank accounts, (ii) the impact and effect of Hutton's cash management policies, procedures and implementation on Hutton's financial statements, net capital under Rule 15c 3-1 under the Securities Exchange Act of 1934 (the "Act") and Formula for the Determination of the Reserve Requirements of Brokers and Dealers under Rule 15c 3-3 ("Reserve Formula") under the Act, and (iii) Hutton's interpretations, applications and computation of net capital under Rule 15c 3-1 under the Act and of the Reserve Formula under the Act.

This subpoena is issued on application of the

THIS SUBPOENA IS ISSUED ON APPLICATION OF THE: UNITED STATES OF AMERICA
Albert R. Murray, Jr.
Asst. U.S. Attorney
Federal Building, Scranton, PA 18501

DONALD R. BERRY
Clerk.

Date March 30 1984

By
Deputy Clerk.

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[1] Strike the words "and bring with you" unless the subpoena is to require the production of documents or tangible things, in which case the documents and things should be designated in the blank space provided for that purpose.

RETURN

Received this subpoena at on
and on at I served it on the
within named
by delivering a copy to and tendering[2] to the fee for one day's attendance and the mileage
allowed by law.

E751986

Date 19

By

[illegible]2-0196/299
ARM:np
GJ# 93-142

SUBPOENA TO TESTIFY BEFORE GRAND JURY

United States District Court

DISTRICT
MIDDLE DISTRICT OF PENNSYLVANIA

TO:
Robert Foman, Chairman of the Board
E.F. Hutton and Company, Inc.
Custodian of the Records

SUBPOENA FOR
☐ Person
☒ Document or Object

YOU ARE HEREBY COMMANDED to appear in the United States District Court at the location, date and time specified below to testify before the Grand Jury in the above entitled case.

PLACE
U.S. Attorney's Office
Room 1078
Federal Building
THird & Walnut Sts.
Harrisburg, PA 17108

COURTROOM

DATE AND TIME
March 15, 1995 - 10:00 AM

YOU ARE ALSO COMMANDED to bring with you the following document(s) or object(s):

All documents including, but not limited to, all writings of any type, kind, or descriptions, letters, memorandum, personal files, journals, notes, ledgers, reports and reviews of E.F. Hutton and Company, Inc. ("Hutton") during the period January 1, 1979 through April 1, 1984 relating directly or indirectly to Hutton's cash management policies, procedures, banking practices, draw-down policy and cash management practices and implementation including, but not limited to, its policies, procedures and implementation on float and over drafting bank accounts.

IN LIEU OF PERSONAL APPEARANCE, DOCUMENTS MAY BE MAILED DIRECTLY TO: ALBERT R. MURRAY, JR., ASSISTANT U.S. ATTORNEY, C/O U.S. POSTAL INSPECTION SERVICE, P.O. BOC 3535, HARRISBURG, PA 17105

☐ *Please see additional information on reverse*

This subpoena shall remain in effect until you are granted leave to depart by the court or by an officer acting on behalf of the court.

CLERK
DONALD R. BERRY

(BY) DEPUTY CLERK

DATE
3/05/95

This subpoena is issued on application of the United States of America by:

the United States Attorney
for the Middle District of PA

NAME, ADDRESS AND PHONE NUMBER OF ASSISTANT U.S. ATTORNEY
ALBERT R. MURRAY, JR.
Assistant U.S. Attorney
309 Federal Building
Scranton, PA 18501

0751987

U.S. Department of Justice

United States Attorney
Middle District of Pennsylvania

Room 426 - Post Office Building
Washington & Linden Streets
Scranton, Pennsylvania 18501

717/961-2924
FTS/592-8301

April 4, 1984

Thomas F. Curnin, Esq.
CAHILL, GORDON and REINDEL
80 Pine Street
New York, New York 10005

RE: E.F. HUTTON & COMPANY, INC.
USAO # 82-0916

Dear Tom:

As per our recent conversation, enclosed herein please find a proposed letter agreement which is self-explanatory. If this arrangement is agreeable to you please execute the original with your client and forward same to this office. We will then execute the agreement and forward a copy to you.

Because you will be unavailable during the month of May, I suggest that as you compile information for the proffer you forward same in increments to our office.

I will be in Harrisburg, Pennsylvania during the week of April 9, 1984. You may contact me at the United States Attorney's Office, (717) 782-4482, or the United States Postal Inspector's Office, (717) 782-4570. If you have any questions concerning this agreement please contact me as soon as possible.

Very truly yours,

DAVID DART QUEEN
United States Attorney

ALBERT R. MURRAY, Jr.
Assistant U.S. Attorney

DDQ:ARM:ly

U.S. Departmen Justice

United States Attorney
Middle District of Pennsylvania

Post Office Building
Washington & Linden Streets
Scranton, Pennsylvania 18501

717/348-2800
FTS/592-8301

April 4, 1984

Thomas F. Curnin, Esq.
Cahill, Gordon and Reindel
80 Pine Street
New York, New York 10005

Re: E. F. HUTTON & COMPANY, et al.,
USAO # 82-0916

Dear Mr. Curnin:

1. You have expressed on behalf of your clients, E. F. Hutton and Company, Inc. and E.F. Hutton Group, Inc. a desire to enter into plea bargain negotiations concerning the criminal investigation being conducted by a Federal Grand Jury for the Middle District of Pennsylvania.

2. You specifically represent that you are authorized by E.F. Hutton Group, Inc. and E.F. Hutton and Company, Inc. to perform all of the terms and conditions of this agreement; to execute same on your clients' behalf; and to bind the Corporation regarding all statements and representations contained in the written proffer.

3. In order to reach a fair, appropriate and just disposition, this office must determine the following: (a) the extent of your clients' culpability in the offense or offenses described in Attachment A; (b) whether criminal conduct on the part of your clients is continuing or historical; (c) to what charges your clients should ultimately plead guilty; (d) what cooperation, if any, your clients can provide; (e) what your client can tell the Government about the criminal involvement of other persons or corporations in the offenses mentioned; (f) what harm or potential harm to the public exists as a result of your clients' conduct; (g) what, if any, position the Government should advocate in implementing the regulations promulgated under the Victim and Witness Protection Act, 18 U.S.C. §1501, et seq. and §3579(3).

4. As a precondition to such a determination, this office must be provided with a complete offer of proof made in the following manner:

a. First, your clients, through you, must provide this office with a detailed written outline of the facts involving your client's culpability and all testimony, information, sources of information, corroborative supporting documents and all other evidence which may be relevant to the Grand Jury's investigation (Attachment A).

b. If, after initial assessment of the written offer it appears that further negotiations are appropriate and in the public interest, the Government, in its sole discretion may require the written offer to be supplemented by a complete interview of your client, its agents or employees, to be conducted by Government investigators and Government attorneys. Thereafter, the value of the evidence your client can provide and your clients' attitude toward cooperation will be assessed, and reported to this office.

5. Prior to the execution of this agreement, no promises, statements, or representations of fact or law have been made by the Government or anyone acting on its behalf that may in any manner be construed to constitute a plea agreement or a promise to enter into a plea agreement.

6. This documents does not constitute a plea agreement or a promise to enter into a plea agreement. The sole purpose of this agreement is to establish the procedure by which the Government will determine what, if any, plea agreement offer should be made to your client.

7. Prior to completion of the above procedures, this office will make no binding commitment concerning the terms and conditions of any final plea agreement with your client. In addition, you are hereby notified that no representation, commitment, understanding or agreement will be considered binding upon the United States Attorney's Office for the Middle District of Pennsylvania, or any other department, agency or organization of the United States, unless and until it is reduced to writing and personally signed by yourself, your client and finally by the United States Attorney.

8. The parties to this agreement specifically understand that nothing in this agreement shall prevent or delay the Federal Grand Jury investigation presently being conducted in the Middle District of Pennsylvania. This investigtion relates to but is not limited to the money and cash management procedures of your client.

9. Subject to the provisions of paragraph 11(b) this agreement shall not restrict Government investigators from pursuing any and all leads or other evidence which may be pertinent to the investigation. Moreover, nothing in this agreement shall in any manner restrict the Grand Jury in the lawful performance of its duty.

10. At the conclusion of the procedures set out in paragraphs 4(a) and (b) the United States Attorney's Office will determine what, if any, plea agreement will be offered to your client. Any plea agreement must be written and in conformity with paragraph 7 above.

11. In the event that no agreement is reached or if negotiations break down at any time for any reason, the following would apply in any criminal trials against your client:

a. The Government would be free to use in any criminal prosecution against your client all available evidence, including evidence obtained through investigation based on and subsequent to your client's offer of proof and interview.

b. The Government agrees, however, that it will not use your client's statements and admissions or other evidence obtained through the procedures outlined in paragraphs 4(a) and 4(b) in its case-in-chief in the above-captioned case.

c. The Government will be free to use in any criminal prosecution against your client all admissions statements, and evidence provided by your client should your client or any of your client's employees, agents or persons acting in its behalf testify in a manner materially inconsistent with such admissions, statements and evidence or if your client or other persons acting in your client's behalf should present a defense materially inconsistent with such admissions, statements and evidence.

12. Nothing in this letter, or any subsequent negotiations, will be construed as an agreement that your client or any of your client's employees, agents, persons acting in its behalf will not be prosecuted for perjury, false declaration, false statement, obstruction of justice or similar crimes, in violation of Sections 1621, 1623, 1001, 1503, 1505, or 1510 of Title 18, United States Code, should any of these offenses be committed by your client at any time subsequent to the execution of this agreement.

13. Any supplemental proffers made by your client shall be in conformity with the provisions of this agreement.

14. No modifications or amendments to this agreement shall be effective unless made in writing and executed by the parties hereto.

15. the original of this letter must be signed and dated by you and your client or its authorized representative and received in the United States Attorney's Office no later than Wednesday, April 11, 1984. Thereafter, the written proffer shall be due on or before April 24, 1984.

16. This agreement will not be binding on the Government until approved and signed by the United States Attorney.

Very truly yours,

DAVID DART QUEEN
United States Attorney

BY: ALBERT R. MURRAY, Jr.
Assistant U.S. Attorney

I understand and accept the procedures, terms and conditions set forth in this letter.

________________________ Date:________________, 1984
Counsel
E. F. HUTTON AND COMPANY, INC.
E. F. HUTTON GROUP, INC.

BY:________________________ Date:________________, 1984

________________________ Date:________________, 1984
DAVID DART QUEEN
United States Attorney

ATTACHMENT "A"

GENERAL INFORMATION

Provide a separate listing of sales offices and their locations for the years 1978 through 1984.

Provide organizational flow charts for the years 1978 through 1984.

INSTRUCTIONS:

When referring to individuals in this proffer, identify them by name, home address, business address, occupation, employer, position held with employer.

When referring to legal entities in this proffer, identify them as follows: (a) sole proprietorship; (b) partnership (general/limited) (c) corporations (d) other forms of syndications. Include headquarters address and general description of the business.

When referring to documents or groups thereof in this proffer, describe them by including the name and date, originator, transmitter or receiver (including current location and current custodian).

And provide brief description of the contents.

ATTACHMENT "A"-1

CRIMES:

Specify and detail possible violations of the following statutes:

Mail Fraud (18 U.S.C. §1341)

Wire Fraud (18 U.S.C. §1343)

Conspiracy (General) (18 U.S.C. §371)

Aiding and Abetting (18 U.S.C. §2)

Also, specify and detail any possible violations of the Anti-Fraud provisions of the Securities Exchange Rules and Regulations, including potential violations of the Net Capital Rule as found in Title 15 U.S.C. et seq. §7, and C.F.R. Sections 15(c)(3), 17(a) 240.15c 3-1, 15c 3-3, 17a-3, 17a-4, 17a-5, 17(a)-11.

Also, specify and detail possible violations of any other provisions of Federal, state or local laws violated by the Company from the period January 1, 1978 to the present.

ATTACHMENT "A"-2

CLIENT CULPABILITY:

Specify and detail all information relating to possible criminal activities involving your client E. F. Hutton and Company, Inc., E. F. Hutton Group, Inc., its employees, agents and servants and/or others from January 1, 1978 to the present which occurred in the Continental United States or in any foreign country.

The categories to be included in your proffer are as follows:

1. Money management procedures and policies implemented by the Company. (National).
2. The cash concentration policy and procedures implemented by the Company. (National).
3. Regional cash concentration and money mangement procedures and policies implemented by the Company. (Regional).
4. Branch money management and cash concentration policies implemented by the Company. (Local).
5. Regional and inter-branch cash concentration policies and cash management policies. (Regional/local-local).
6. Branch overdrafting policies and procedures.
7. Regional overdrafting policies and procedures
8. Revenue received from branch, regional or national overdrafting policies, including its source and utilization (Investment).
9. Any policy and procedure adopted by the Company for the overdrafting of bank accounts of any classification, e.g. the overdrafting of bank accounts of any classification, e.g. [illegible] Deposit [illegible])Lock-box accounts, Commodity Exchange

10. Any sums expended by the Company to reimburse financial institutions for alleged losses resulting from the money management policy or cash concentration policy of the Company, or any of the procedures outlined in paragraph 1 to 9 inclusive.

11. Company policy or procedures relating to the creation of delayed disbursements and the creation of artificial bank balances.

12. Any and all revenue derived from the activities described in paragraphs 1 through 7 and 9 or losses to financial institutions, or both.

13. Net capital computations for the applicable years 1978 to the present, as it is affected by the activities described in paragraphs 1 through 9 and 11 inclusive.

14. For the calendar years ending 12/80-12/81, 12/82 and 12/83 the composition of drafts and checks payable, as reported in the Companies Annual Reports.

15. Any and all other possible criminal activity relating to the money management or cash concentration policies of the Company which may have resulted in a profit to the Company or a loss to an individual or institution.

ATTACHMENT "A"-3

CO-CONSPIRATORS AND AIDERS AND ABETTERS:

Identify all persons or legal entities known to the Company which have engaged in activities which may form a part of the offenses previously described.

U.S. POSTAL SERVICE
INSPECTION SERVICE

REPORT OF POSTAL INSPECTOR

TYPE OF REPORT
☒ PRELIMINARY ☐ FINAL
☐ SPECIAL ☐ SUPPLEMENTAL

OFFICE: WILKES-BARRE, PA
ZIP CODE: 18701
DATE: June 26, 1984
CASE NUMBER: 115-8202318-F(2)

SUBJECT
Check Kiting - Alleged Violator: E.F. Hutton
Court House Square, 212 N. River St.
TASK FORCE CASE - TEAM A
~~REGIONAL~~ CHIEF INSPECTOR INTEREST
(4-14-82)

RESTRICTIONS
RULE 6E MATERIAL INCLUDED

POSTAL INSPECTOR: J. A. Holland /ag
POSTAL INSPECTOR IN CHARGE: Harrisburg, PA 17105-9000

REVIEWERS' INITS											
DATE											

DISTRIBUTION			ROUTING					
INITS	DATE	AGENCY	INITS	DATE	TO	INITS	DATE	TO
		Inspection Service ONLY			Chief Inspector			
		USPS			RCI			

1. Personal attention has been given this case at Harrisburg, PA on a continuing basis since submission of the preliminary report dated May 31, 1984. Basis for the case was a report dated March 19, 1982 sent to the Postal Inspector in Charge, Philadelphia, PA, by Joseph Modla, an Examiner for the Federal Deposit Insurance Corporation, reporting an alleged check kiting scheme involving the E. F. Hutton Company, Inc. using an account at the United Penn Bank, Wilkes-Barre, PA, among others.

2. As reported in the latest preliminary report, task force efforts during the last three weeks of May were primarily directed toward completing an inventory of potential Grand Jury/Trial Exhibits, pulling documents for individual counts and completing charting tasks. Those efforts were completed during the month of June. In addition, considerable time was spent with Assistant U. S. Attorney Albert R. Murray, Jr. for the purpose of completing a draft of a proposed indictment. That task was [redacted]

PS Form
Mar. 1978 2020

[redacted] The proposed indictment is approximately 650 pages in length and was used by Assistant U. S. Attorney Albert R. Murray, Jr. and U. S. Attorney David Dart Queen in their meeting with the Attorney General's staff in Washington, D.C. on June 25, 1984 (rescheduled from June 15, 1984 as indicated in the last preliminary report).

3. The appearance of Grand Jury witnesses continued at Harrisburg, PA with witnesses appearing on [redacted]

4. Through the use of the IBM Personal Computer and the Lotus Software Package, charts relating to the kiting activities of the company at banks in Wilkes-Barre, PA, Williamsport, PA and Harrisburg, PA, all in the Middle District of Pennsylvania, have been prepared. These charts show the difference between the customer money deposited into the various E. F. Hutton and Company, Inc. Branch Bank Accounts, the additional deposit of kited funds in these accounts and the daily drawdown of those accounts throughout the period of the kite. It is interesting to note that the kite was not being conducted simultaneously in each location. It is also interesting to note that the kited funds represent approximately [redacted]

[redacted]

8. Considerable effort was also expended by members of this task force in the preparation of computer charts and other charts for use by Assistant U. S. Attorney Albert R. Murray, Jr. and United States Attorney David Dart Queen in their meeting with the Attorney General's staff on June 25, 1984. Prior to the meeting, Assistant U. S. Attorney Murray met with Mr. Robert Ogren, Chief of the Fraud Section, Criminal Division, for four hours on June 25, 1984 to explain the investigation. At 4:00 P.M., Assistant U. S. Attorney Murray and U. S. Attorney Queen met with the rest of the staff for a scheduled one hour meeting which lasted until 6:30 P.M. As a result of the presentation, the Attorney General's staff acknowledged that they had never experienced an investigation of this magnitude and that they would not agree to any plea agreement that did not include individual defendants in addition to the corporations.

[redacted]

10. Assistant U. S. Attorney Murray was commended by the staff for his competence and thoroughness in handling this investigation without the assistance of other prosecutors. According to Mr. Murray, he said that he is not without assistance, he has 15 of the best investigators available assisting him, U. S. Postal Inspectors.

11. Additional reports will be submitted on a continuing basis.

J. A. Holland
Postal Inspector

Bob:

I talked with Tom Curnin of Cahill, Gordon this afternoon and asked him to send us a letter indicating the details of Robert Foman's contact with Attorney General Smith. I suggested that the letter contain Foman's recollection of when and where he arranged to meet with the AG, what he said to the AG and vice-versa. Curnin asked why we didn't just ask the AG, and I said we wanted Foman's version of the event. Curnin said "I hear you", which to me means he isn't agreeing or refusing to send the letter, but wants to mull it over. You may hear about the request via Hundley, so forewarned is forearmed. Do you want to keep on top of our request for details from Steve Trott? I think we should get the AG's version on record before he leaves.

Peter

Peter —

Spoke w/ Hundley & underscored our need for the ~~Ex~~ document — I think we'll get the letter.

Bob

4..3

t: 2/4/85

[illegible]O:JPC:PBC:e[illegible]
26-63-157

FEB 4 1985

Thomas F. Curnin, Esquire
Cahill, Gordon & Reindel
80 Pine Street
New York, New York 10005

Re: E.F. Hutton Group, Inc.

Dear Mr. Curnin:

This is to confirm my request, made during our telephone conversation earlier today, that I be furnished with a letter detailing the meeting which your client, Mr. Robert Foman, requested of Attorney General William French Smith. As I indicated, we wish to know your client's version of the incident, including the date and circumstances of Mr. Foman's request for a meeting, including the reason, if any, given for the request, and the circumstances of the meeting itself, including your client's recollection of what was said by him and the Attorney General.

Sincerely,

Robert W. Ogren
Chief, Fraud Section
Criminal Division

Records
Clark (2)
Section Chron.

By:
Peter B. Clark
Trial Attorney

CAHILL GORDON & REINDEL

EIGHTY PINE STREET
NEW YORK, N.Y. 10005

FLOYD ABRAMS
ROGER ANDRUS
HENRY G. BISGAIER
CARL M. BORNMANN
P. KEVIN CASTEL
WALTER C. CLIFF, P.C.
BENJAMIN J. COHEN
JOSEPH P. CONWAY
MARSHALL COX
THOMAS F. CURNIN
CHARLES F. DETMAR, JR.
W. LESLIE DUFFY
RAYMOND L. FALLS, JR
PATRICIA FARREN
BART FRIEDMAN
CIRO A. GAMBONI
CHARLES A. GILMAN
STEPHEN A. GREENE
ROBERT M. HALLMAN
EDWARD A. HANSEN
WILLIAM E. HEGARTY
DAVID R. HYDE
THOMAS R. JONES
ALLEN S. JOSLYN
THOMAS J. KAVALER
LAWRENCE A. KOBRIN
IMMANUEL KOHN
WILLIAM T. LIFLAND
MICHAEL MACRIS

JONATHAN I. MARK
DENIS McINERNEY, P.C.
RAND McQUINN*
GERARD M. MEISTRELL
CLIFFORD L. MICHEL
JOHN P. MITCHELL
MATHIAS E. MONE
HUGH P. MORRISON, JR.*
DONALD J. MULVIHILL
KENNETH W. ORCE
CHARLES PLATTO
ROY L. REGOZIN
DEAN RINGEL
THORN ROSENTHAL
IRWIN SCHNEIDERMAN, P.C.
H. RICHARD SCHUMACHER
LAURENCE T. SORKIN
LEONARD A. SPIVAK
GERALD S. TANENBAUM
DUDLEY B. TENNEY, P.C.
MICHAEL P. TIERNEY
ROBERT USADI
JOHN R. VAUGHAN
GEORGE WAILAND
RALPH O. WINGER
GARY W. WOLF
JOHN R. YOUNG
R. ANTHONY ZEIGER

SAMUEL ESTREICHER
JOHN J. STANTON, JR.
DAVID J. YERES
COUNSEL

FREDDY DRESSEN**
EUROPEAN COUNSEL

MARVIN S. GOLDKLANG
JERROLD G. VAN CISE
OF COUNSEL

WASHINGTON, D. C. OFFICE
1990 K STREET, N. W.
WASHINGTON, D. C. 20006

EUROPEAN OFFICE
19 RUE FRANÇOIS 1ER
75008 PARIS, FRANCE

TELEPHONE 212-701-3000
TELEX 127066
TELECOPIER 212-701-3577

*ADMITTED D. C. ONLY
**ADMITTED FRANCE ONLY

WRITER'S DIRECT NUMBER

212-701-3609

February 14, 1985

Dear Mr. Clark:

In response to your request that I advise you of the substance of Mr. Robert Fomon's November discussion with The Honorable William French Smith, please be advised that at the conclusion of a social lunch with Mr. and Mrs. Smith and Jay Moorhead of E.F. Hutton on November 15, 1984, Mr. Fomon stated that there was a grand jury investigation of E.F. Hutton in the Middle District of Pennsylvania looking into the company's banking practices, that he was informed that the grand jury was considering indicting the company, that the company had made one written submission to the Department of Justice, that it had other submissions it wanted to present to the Department but, as he understood it, the grand jury was about to expire and that the company might not be afforded an opportunity to present these submissions. The essence of Mr. Smith's response was that he would look into the matter.

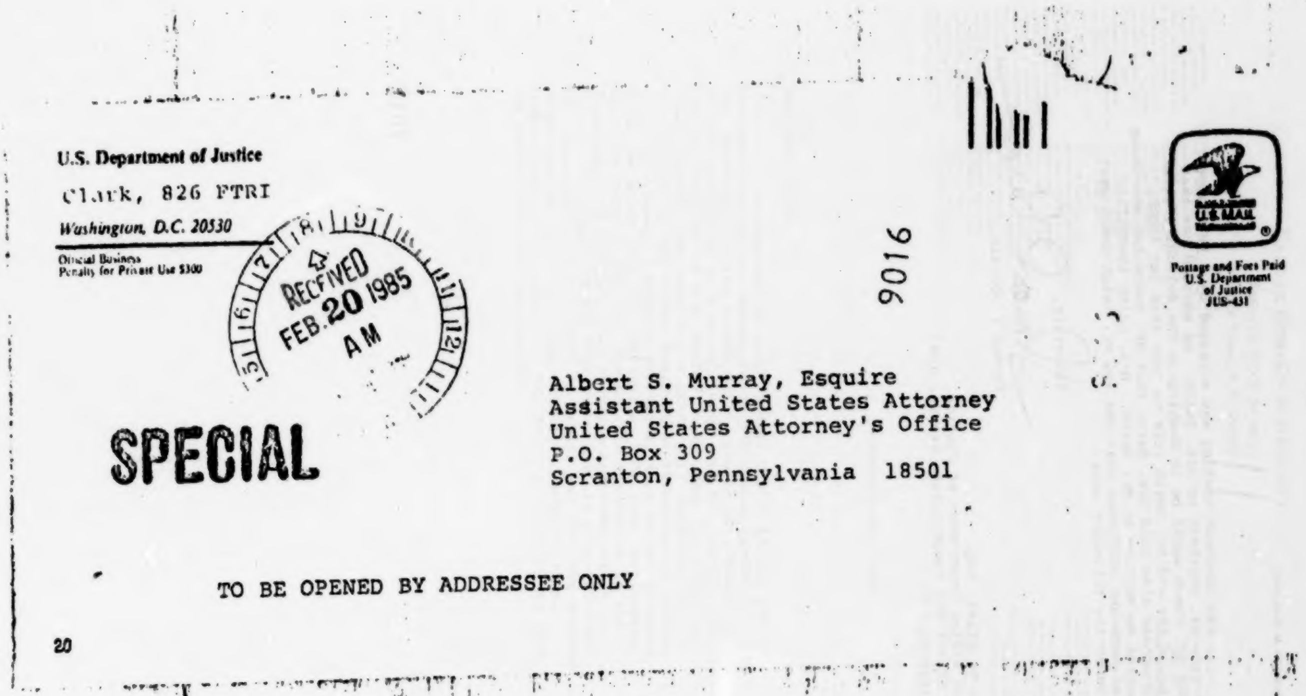
Cahill Gordon & Reindel

The luncheon meeting was arranged by a telephone call from Mr. Moorhead to Mrs. Smith. He advised her that he and Mr. Fomon would be in Washington the following week and would she and Mr. Smith like to join them for lunch. Mr. Moorhead also told Mrs. Smith that Mr. Fomon had something he wanted to mention to Mr. Smith. Mrs. Smith thereafter called back and confirmed that she and Mr. Smith could meet for lunch the following week.

Sincerely,

Thomas F. Curnin

Peter B. Clark, Esq.
United States Department of Justice
10th Street and Constitution Avenue, N.W.
Washington, D.C.



U.S. Department of Justice
Clark, 826 FTRI
Washington, D.C. 20530

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U.S. Department
of Justice
JUS-431

Albert S. Murray, Esquire
Assistant United States Attorney
United States Attorney's Office
P.O. Box 309
Scranton, Pennsylvania 18501

TO BE OPENED BY ADDRESSEE ONLY

20

Bob:

According to Al Murray, Steve Trott was asked by Dave Queen to call Ken Fletcher, the Chief Postal Inspector (245-5445) to request that the Postal Service maintain their level of commitment on the Hutton case during the period that the grand jury will be extended. Apparently the regional inspector in Philadelphia has said he wants to pull the team off until the case is indicted. I'm not sure we need to remind Steve to do something, but Murray has asked that we inquire as to whether Steve has spoken with Fletcher. Since you have had the contact with Steve on Hutton, it might be better if you asked him.

I'll be in Harrisburg on Friday, and will file the motion to extend the grand jury's term. If you speak with Steve, please let me know the result so I can tell Murray and Queen.

Peter

[illegible] 11/26/84 [illegible]

[illegible] 22

U.S. POSTAL SERVICE
INSPECTION SERVICE

REPORT OF POSTAL INSPECTOR

TYPE OF REPORT
☒ PRELIMINARY ☐ FINAL
☐ SPECIAL ☐ SUPPLEMENTAL

OFFICE Wilkes Barre, PA
ZIP CODE 18701
DATE February 28, 1985
CASE NUMBER 115-3202318-F(1)

SUBJECT
Check Kiting - Alleged Violator:
E. F. Hutton, Court House Square,
312 N. River St.
TASK FORCE CASE - TEAM A
CHIEF INSPECTOR INTEREST

RESTRICTIONS
RULE 6E MATERIAL INCLUDED

POSTAL INSPECTOR J. A. Holland /ag
POSTAL INSPECTOR IN CHARGE Harrisburg, PA 17105-9000

REVIEWERS' INITS											
DATE											

DISTRIBUTION			ROUTING					
INITS	DATE	AGENCY	INITS	DATE	TO	INITS	DATE	TO
		Inspection Service ONLY			Chief Inspector			
		USPS			RCI			

1. Personal attention has been given this case at Harrisburg, PA; Scranton, PA; New York, NY; and Washington, DC on a continuous basis since submission of the preliminary report dated October 10, 1984. Basis for the case was a report dated March 19, 1982, sent to the Postal Inspector in Charge, Philadelphia, PA, by Joseph Modla, an Examiner for the Federal Deposit Insurance Corporation, reporting an alleged check kiting scheme involving the E. F. Hutton Company, Inc., using an account at the United Penn Bank, Wilkes Barre, PA, among others.

2. As indicated in the latest preliminary report, the grand jury was scheduled to expire on November 21, 1984. During the weekend of November 11 and 12, 1984, Postal Inspectors J. C. Conroy and the undersigned assisted AUSA Albert R. Murray, Jr. in preparing a final draft copy of an indictment which was to be presented to the grand jury prior to its expiration. However, at the request of the Department of Justice, an indictment was not presented to the grand jury since the company and the targeted suspects had requested permission to speak directly with the Department of Justice prior to the presentation of an indictment. As requested by the Department of Justice, an extension of the grand jury for a period of six months was obtained from the Honorable Sylvia Rambo, Federal Judge, Harrisburg, PA. Attorneys for the company were requested to make written submissions to the Department of Justice after which a decision would be rendered. Beginning in November of 1984, the company began providing submissions to the Department of Justice,

4 35

copies of which were presented to AUSA Murray. During the months of November and December, the company presented a total of five written submissions to the Department of Justice, as well as three written submissions on individual targets. The submissions were reviewed and found to contain little information of merit and a lot of misstatements of fact as well as half-truths. The submissions were critiqued by AUSA Murray and Postal Inspectors and the critiques were presented to the Department of Justice.

3. On January 7, 1985, a meeting was held at the Department of Justice in Washington, DC. Present at the meeting were Mr. Stephen Trott, Chief, Criminal Division; Mr. Robert Ogren, Chief, Fraud Section, Mr. Peter Clark, Trial Attorney, Fraud Section; Albert R. Murray, Jr., AUSA, Middle District of Pennsylvania; Mr. William G. Hundley, Hundley and Cacheris, Law Firm; Thomas F. Curnin and Thomas J. Kavaler, Attorneys, Cahill, Gordon and Reindel, Law Firm; J. Clayton Undercofler, III, Attorney, Dilworth, Paxson, Kalish and Kaufman, Law Firm; and Thomas Fitzpatrick, Attorney, as well as Inspector in Charge Thomas J. Dagley and the undersigned. The purpose of this meeting was to give the attorneys for the company, i.e., Hundley, Curnin, Kavaler, Undercofler and Fitzpatrick, the opportunity to make an oral presentation in addition to their written submissions. The meeting lasted for approximately 2 1/2 hours, after which the attorneys for the company were advised that a decision would be rendered and provided them after the prosecution team caucused. It became apparent after the meeting that the Department of Justice would authorize prosecution of at least the firm. Mr. Trott advised that due to the resignation of David Dart Queen as United States Attorney for the Middle District of Pennsylvania, Mr. Trott was taking over direct supervision of the prosecution of this case. He also advised that Mr. Murray would remain as lead counsel for the government. It was also decided that a decision relative to the culpability of individuals would be rendered after Mr. Ogren and Mr. Clark had occasion to review documents.

4. On two occasions during January and February of 1985, Mr. Clark and Mr. Ogren visited Division Headquarters in Harrisburg, PA for the purpose of reviewing documents relating to individuals' culpability in this case. While in Harrisburg on January 15 and 16, 1985, Mr. Ogren advised that the company would be notified the following week that it was to be indicted. He also advised that of the different fraudulent practices of the company that had been identified, the most appealing from a prosecutive standpoint were the chain link drawdowns, the purpose of which is the creation of float. Mr. Ogren requested additional investigative effort (charting) to further develop that aspect. Arrangements were made to identify and isolate approximately twenty horizontal drawdowns and six Postal Inspectors from the Eastern Region assisted Inspectors on this Task Force in charting approximately 190 months of activity.

5. Mr. Clark and Mr. Ogren returned to Harrisburg on February 7 and 8, 1985 to continue reviewing documents relating to individuals' culpability. Upon completion of this review, Mr. Ogren was satisfied that sufficient evidence existed for indicting individuals as well as the corporation. Mr. Ogren also determined that the activities of the company throughout the country should be charged in a conspiracy count in the indictment. This decision has necessitated verification of the charting previously done and will result in augmenting the Task Force with the individuals from the Eastern Region who previously assisted the Task Force in the original charting. It is estimated that two weeks will be required to complete this activity and that it will begin in Harrisburg on March 4, 1985.

6. At this point in time, there is one remaining project of major significance to be completed in this investigation. This project relates to document control. Over the past year, considerable effort was expended in inventorying the records in this investigation which number in the millions. An attempt was made at utilizing the 5520 System for inventorying and controlling the more significant of those documents. The effort was not successful. An article written by Barbara Nicastro, a Trial Attorney in the Fraud Section, Department of Justice, was recently obtained. In this article, Mrs. Nicastro explains a system she has developed for assistance in document control, retrieval and use at trial. The system she employs is a manual system for cases involving several hundred to several thousand records. The system employs a combination of numbers and letters affixed to documents which assist in not only identifying the particular document, but also locating the document, preparing witness lists, preparing trial exhibit lists and preparing source lists. Meetings have been held in Harrisburg, PA over the past two weeks for the purpose of devising a computerized system which will give us the same capability, i.e., document control, retrieval and use at trial. Inspector Raleigh Demby is in the process of writing a program based on information provided him by AUSA Murray and members of the Task Force. It is expected that the program will be available on March 6, 1985 and that beginning March 4, 1985, members of the Task Force, supplemented by Clerks from the Harrisburg Post Office, will begin a systematic inventory of all records which will be input into a system over the next several weeks. Inspector Demby advises that an IBM PC AT with a 40 megabyte drive will be required for this purpose. Attempts are being initiated immediately in locating a machine with that capability.

J. A. Holland

J. A. Holland
Postal Inspector

Memorandum

Subject E.F. HUTTON	Date 12-28-84
To PETER B. CLARK, ESQUIRE	From ALBERT R. MURRAY, JR. Assistant U.S. Attorney

Enclosed herein please find materials for Mr. Trott and Mr. Ogren's review.

David Dart Queen and myself have met with all targeted defendants and we are prepared to recommend prosecution against the individuals named in the Indictment.

Happy New Year!

ARM:jak

P.S. Also, please find Grand Jury witness summaries which are for you only.

U.S. Department of Justice

Criminal Division

Assistant Attorney General

Washington, D.C. 20530

December 31, 1984

Hon. David D. Queen
United States Attorney
Post Office Box 309
Scranton, Pennsylvaria 18501

Dear David:

Just a note to confirm our conversation last week about the Hutton case. Effective with your resignation, direct supervision of the case will be transferred to the Criminal Division in Washington. In that regard, although Al Murray shall remain as the lead lawyer and number one chair on the case, he and Peter Clark shall report directly to Bob Ogren who in turn shall report through my deputy Victoria Toensing to me. Between now and your departure, it is expected that you will continue to work on the case and give us the benefit of your analysis of it before you leave.

Good luck in your new job. I look forward to continuing to work with you in your capacity with the Department of the Treasury.

Sincerely,

Steve

Stephen S. Trott

cc: D. Lowell Jensen
John C. Keeney
Victoria Toensing
Robert Ogren

U.S. Department of Justice

Criminal Division

Office of the Assistant Attorney General *Washington, D.C. 20530*

AUG 2[illegible]

Mr. Peter B. Clark
Criminal Division
Department of Justice
Washington, D.C. 20530

Dear Mr. Clark:

As an attorney for the Government employed full time by the Department of Justice and assigned to the Criminal Division, you are hereby authorized and directed to file informations and to conduct in the Middle District of Pennsylvania and any other judicial district any kind of legal proceedings, civil or criminal, including grand jury proceedings and proceedings before United States Magistrates, which United States Attorneys are authorized to conduct.

You may file a copy of this letter with the Clerk of the District Court to evidence this authorization.

Sincerely,

Stephen S. Trott
Assistant Attorney General
Criminal Division

By: John C Keeney
John C. Keeney
Deputy Assistant Attorney General
(Pursuant to Order No 725-77, dated
May 12, 1977)

Peter

[illegible]T: 8/28/84

AUG 28 1984

Grand Jury Authorization

RWO:TPC:PBC:sag

Stephen S. Trott
Assistant Attorney General
Criminal Division

Robert W. Ogren
Chief, Fraud Section
Criminal Division

It is requested that Peter B. Clark, an attorney with the Fraud Section employed full time by the Criminal Division and not on detail from any other agency, be authorized to conduct grand jury proceedings in the Middle District of Pennsylvania. This authorization is required in connection with an investigation of E.F. Hutton, Inc. focusing primarily on, but not limited to alleged violations of the federal Mail Fraud Statute (18 U.S.C. 1341). This authorization is needed by close of business on August 29, 1984.

The United States Attorney for the above district concurs in the granting of this grand jury authorization.

Section Chron.
Clark(2)
Murphy
Washington
Grand Jury Folder

U.S. POSTAL SERVICE
INSPECTION SERVICE

REPORT OF POSTAL INSPECTOR

TYPE OF REPORT
☒ PRELIMINARY ☐ FINAL
☐ SPECIAL ☐ SUPPLEMENTAL

OFFICE: WILKES-BARRE, PA
ZIP CODE: 18701
DATE: October 10, 1984
CASE NUMBER: 115-8202318-F(2)

SUBJECT
Check Kiting - Alleged Violator: E. F. Hutton
Court House Square, 212 N. River Street
TASK FORCE CASE - TEAM A
CHIEF INSPECTOR INTEREST
(4-14-82)

RESTRICTIONS
RULE 6E MATERIAL INCLUDED
4040

POSTAL INSPECTOR: J. A. Holland /djg
POSTAL INSPECTOR IN CHARGE: Harrisburg Division

REVIEWERS' INITS											
DATE											

DISTRIBUTION			ROUTING					
INITS	DATE	AGENCY	INITS	DATE	TO	INITS	DATE	TO
		Inspection Service ONLY			Chief Inspector			
		USPS			RCI			

1. Personal attention has been given this case at Harrisburg, PA; Scranton, PA; Chicago, IL; Tyler, TX; and Pittsburgh, PA, on a continuous basis since submission of the Preliminary Report dated July 31, 1984. Basis for the case was a report dated March 19, 1982, sent to the Postal Inspector in Charge, Philadelphia, PA, by Joseph Modla, an examiner for the Federal Deposit Insurance Corporation, reporting an alleged check kiting scheme involving the E. F. Hutton Company, INC. using an account at the United Penn Bank, Wilkes-Barre, PA, among others.

2. The Grand Jury has continued to hear witnesses in this matter on [redacted]

3. Task Force efforts since the latest Preliminary Report have involved preparation for the appearance of Grand Jury Witnesses, charting and verification of charting, identifying additional overt acts, misrepresentations and allegations for indictment purposes, and preparing suspect files for seven (7) identified suspects.

4. Clerical assistance was provided by the Postmaster, Harrisburg, PA, through the loan of two part-time flexible clerks who were instrumental in generating information to be placed in to the IBM PC as well as reorganizing approximately three file cabinets full of documents. These employees completed a one month detail to the Inspection Service during the last week of September, 1984 and a letter of appreciation was sent to the Postmaster, Harrisburg, PA by the Inspector in Charge.

PS Form 2029
Mar. 1978

5. During the past week, AUSA Albert R. Murray, Jr., entered into negotiations with the attorneys for individuals already targeted in this investigation. Additional meetings with the attorneys are expected to be held during the week of October 15, 1984.

6. Additional reports will be submitted as warranted.

J. A. Holland
Postal Inspector

U.S. Department of Justice

Criminal Division

Assistant Attorney General

Washington, D.C. 20530

May 29, 1985

The Honorable John Glenn
United States Senate
Washington, D.C. 20510

Dear Senator Glenn:

Your letter of May 7, 1985, to the Attorney General concerning the pleas of guilty we attained in the E.F. Hutton case appears to be based on a misunderstanding of the unusual factual and legal complexities of the case, the remarkable scope of the plea agreement, the positive benefits of this result for the nation's banking industry, and the extraordinary and immediate relief secured for the victims of the fraud. I hope that this misunderstanding has been cleared up by the comprehensive briefings we have now provided to numerous staff members of both the Senate and the House. But, if any questions remain, we will be pleased to make available to you again the key career people who made the critical decisions on this case -- all of which I continue strongly to endorse -- to relieve your concerns.

For what amounted to deceiving banks into giving it interest-free unsecured short-term loans, Hutton was required to plead guilty -- not nolo contendre -- to an unprecedented 2000 felony counts of intentional mail and wire fraud. No leeway was given to the company in the settlement or plea process to advance any claim that this swindle might somehow be just a smart business practice. It was fined $2,000,000, the maximum the law allows for this unparalleled number of counts and a sum which makes it the steepest fine in the history of our white collar enforcement effort. Hutton was also required to pay the Government $750,000 to cover the costs of the investigation which are ordinarily not recoverable, even with a jury verdict of guilty. Additionally, the new injunctive provisions of 18 U.S.C. §1345 were used for the first time since their enactment by Congress in October 1984 to enjoin all of Hutton's cash management abuses, not just those precisely identified in the criminal information.

NOTE: An original letter was also sent to the following Senators: Robert C. Byrd, John Melcher, Paul Sarbanes, Thomas Eagleton, Gary Hart, Daniel Inouye, Tom Harkin, Edward Kennedy, Jeff Bingaman, Albert Gore, Jr., John D. Rockefeller IV, Alan Cranston, Paul Simon, Christopher Dodd.

More importantly, however, the Department of Justice demanded that Hutton immediately make full and complete restitution (plus interest) to each and every one of the bank victims without regard to the federal district in which they reside, which it is now starting with a letter of apology. Rarely is there a criminal fraud case where this much immediate benefit flows to the victims. Usually their interests are handled as an afterthought. It is incorrect to assume or infer that restitution is limited to the $8,000,000 Hutton has reserved for this purpose. Hutton is obligated to pay back the total amount stolen, plus interest, whatever that may be. In sum, this is the most comprehensive program of restitution ever developed in a federal criminal case.

It must be noted in connection with this key condition of the settlement -- which we dictated as a sine qua non of the plea -- that the precise offenses and victim banks that could have been alleged in any indictment would have been limited to the offenses committed within the federal district in which the case was brought. By force of federal law on the subject of venue, the full extent of Hutton's misdeeds and victims could not be expressed in a single indictment, only those in the district where an indictment might have been returned. This venue limitation among other disadvantages created the possibility that a post-conviction order of restitution could have excluded all other victim banks.

In addition to looking after the interests of the individual victims, it is also one of the important priorities of the Department of Justice to protect the banking industry itself from fraudulent schemes and predatory money-management practices. Cash concentration systems, as you can see from the article I am enclosing from the American Banker, have become a science. Professionals working in that specialty have associations which sponsor conferences, exchange information, and publish articles. The activities of this highly technical industry have a definite impact on our nation's banks and financial institutions of which few people are aware. The Federal Reserve has been highly critical of "float-playing games," of which Hutton's was an extreme example, and we are in agreement with that concern. Hutton's practices, if replicated by financially precarious companies, have tremendous potential for harming banks, particularly the smaller, more vulnerable ones. The clear message sent to money managers around the country by this conviction coupled with the injunction that covers conduct that we were unable to include in our charging document achieved important multiple objectives in a single decisive stroke. It left no doubt that these kinds of abuses are criminal and will be prosecuted.

The public must have faith in the stability of our financial institutions, and they must have it today, not tomorrow. Naming numerous small banks victimized by Hutton in an unresolved indictment and alleging widespread fraud and losses had the capacity to undercut public confidence in those banks. If that route had been chosen and runs on deposits had developed, the situation would have been highly undesirable. One only has to look to the recent problems in Ohio and Maryland to see how fragile public confidence can be when it appears to depositors that the financial institution to whom their money has been entrusted is on shaky ground. The plea of guilty plus complete restitution without a risky, costly, and lengthy trial achieved our objectives, now, not two or three years from now. The word is out. The cloud is gone. The matter has been favorably resolved without the uncertainties and vagaries of protracted litigation. In that regard, our trial lawyers estimated that a trial would have involved some 300 witnesses and several hundred thousand documents to prove our case.

The legal context for this case is very thorny. Check kiting as a scam became extremely difficult to prosecute under federal law as a result of the Supreme Court's decision in United States v. Williams, 458 U.S. 279 (1982). The typical check kite case had previously been prosecuted in the federal system as a violation of 18 U.S.C. §1014. The relevant language is:

> Whoever knowingly makes any false statement or report, or willfully overvalues any land, property or security, . . . for the purpose of influencing in any way the action of . . . any bank the deposits of which are insured by the Federal Deposit Insurance Corporation . . . upon any application, advance, discount, purchase, purchase agreement, repurchase agreement, commitment, or loan, or any change or extension of any of the same, by renewal, deferment of action or otherwise, or the acceptance, release, or substitution or security therefor, shall be fined not more than $5,000 or imprisoned not more than two years, or both.

The theory employed by federal prosecutors prior to 1982 was that a kited check was an "overvalued security" or a "false statement." The Supreme Court held, however, that a check does not "make any representations as to the state of petitioner's bank balance," 458 U.S. at 285, nor is it an overvalued security.

The consequence of Williams was to limit drastically federal law enforcement's ability to prosecute check kites. As a direct result, the Department of Justice recommended remedial legislation in the form of a comprehensive bank fraud statute. That statute, now codified at 18 U.S.C. §1344, was adopted by Congress as part of the Comprehensive Crime Control Act of 1984. The legislative history makes it clear that §1344 reverses Williams, but the new statute could not be used in this case because of the prohibition against ex post facto application of the law.

Before passage of §1344, the principal alternative to §1014 as a check kite prosecutive vehicle was mail or wire fraud in the limited cases where those statutes applied. In the Third Circuit, however, Williams took its toll on the "mail fraud/wire fraud" approach to prosecuting check kites. In United States v. Frankel, 721 F.2d 917 (3rd Cir. 1983), the Court relied on Williams to conclude that a check kite could not be charged under the "false pretenses, representations and promises" clause of 18 U.S.C. §1341 because a check was not a representation. Frankel left open the possibility of a prosecution under the "scheme to defraud" clause, but failed to explain how that could be done.

The net effect of the Williams and Frankel decisions was to circumscribe our ability to prosecute check kites both nationally as well as in the Third Circuit. Finding a theory that would not lead to a dismissal under either Williams or Frankel was not simple. The theory adopted, and reflected in the information charging Hutton, focused on a misrepresentation of Hutton's relationship with its banks: Hutton held itself out as creating depository accounts to handle only customer money where in fact the accounts were used to process huge overdraft checks. This is a rather unconventional prosecutive approach to check kiting and turned completely on our ability to establish persuasively that the depository accounts were intended for a highly specific limited use. Obviously, this creative circumvention of Williams and Frankel would be tested vigorously.

The second legal defense we expected was a claim of good faith. Hutton alleged it was guilty merely of aggressive money management. In fact, Hutton insisted that they had done nothing wrong and had only attempted to "recapture float" that did not belong to the banks. Hutton insisted that its practices were no different than those of other companies.

The third legal attack on our case, available to the individuals who might have been charged, was the simple claim that each was acting pursuant to corporate policy and because Hutton had the means to pay the banks, the requisite mens rea, was absent.

As to the individuals primarily responsible in a criminal sense for this activity, there were essentially two key people. Beyond that they cannot be identified -- nor can the evidence against them be detailed or characterized -- because of Rule 6(e) of the Federal Rules of Criminal Procedure that requires continuing secrecy with respect to matters occuring before a grand jury. However, neither individual was a high-level executive of the company.

To understand where these individuals fit within Hutton's organization and to explain the plausibility of a lack of high--level executive knowledge of the details of this activity, it is helpful to understand how Hutton is organized.

The operations of a brokerage firm such as Hutton are organized into two functional areas: the "front office," which performs all the sales-related activities and the "back office," which handles the paperwork generated by the front office and all of the other day-to-day operations -- including the "money management" of the firm. The sales personnel are the best compensated and are rewarded by promotion to management positions. The "back office" personnel, who perform the mundane, albeit, in some cases, extremely responsible tasks are not well compensated and have virtually no opportunity to advance into the senior management levels of a brokerage firm. Senior managers, selected without exception from the ranks of the "front office," have neither the experience nor the inclination to become involved with back office management. Second, unlike other major brokerage firms, Hutton's regional and branch operations were effectively "decentralized." Indeed, the regional and branch managers were encouraged to be independent and closely monitored profit and loss figures for each branch. The individuals primarily responsible for Hutton's criminal activity worked in the "money management" or "cash concentration" part of the "back office." Based on who they were, where they worked, what they did, what they personally got out of the scheme and other relevant factors, it was the considered view of our trial lawyers that even if convicted, only a minimal jail sentence was probable and indeed a sentence of no jail time was not out of the picture.

In assessing the manner in which this case ought to be handled, our prosecutors started from the proposition that individuals ought to be held personally responsible for their criminal misconduct. This is our normal policy from which we deviate only when faced with a compelling reason to make an exception. Pursuing in court in this case the known individual authors of the swindle would have had some merit, but not at the expense of foregoing the opportunity to dictate the key terms of and seize without delay this extraordinary settlement. To prosecute the individuals would have required us to drop the settlement in favor of a protracted court fight that would have taken years to complete. That was the choice. Our career prosecutors opted for the numerous overwhelming benefits of the immediate solution, and we find their judgment to be absolutely sound and above approach. The benefits derived from the Hutton plea were so substantial that they clearly warranted an exception to our policy of affixing personal responsibility for wrongdoing.

When it is appropriate in the pursuit of justice to pursue individual white collar criminals as well as the companies for which they work, we do. The four-year federal prison sentence handed out recently to former Deputy Defense Secretary Paul Thayer and Dallas stockbroker Billy Bob Harris for their parts in an illegal stock scam, the 20-year prison exposure faced by Jake Butcher in Kentucky and Tennessee for insider bank fraud, and the 35-year sentence meted out to Fred Soudan in Houston for maritime fraud -- all within the last 60 days -- testify unmistakably to this policy. Standing together they provide clear evidence of the commitment of the Department to bring the hammer of justice down hard on economic crime and economic criminals.

Thank you for your consideration.

Sincerely,

/s/ STEPHEN S. TROTT
Stephen S. Trott

Enclosures

MC:eah
113-017-63

AUG - 7

Charles A. Stillman, Esquire
Stillman, Friedman & Shaw, P.C.
521 Fifth Avenue
New York, New York 10175

Re: E.F. Hutton

Dear Mr. Stillman:

This is in response to your letter joined in by Andrew H. Lawler and Loretta A. Preska, to Stephen S. Trott, dated June 25, 1984, in regard to E.F. Hutton, Inc., William Sullivan, Michael Castellano and Thomas Morley. We have noted your request to make a joint presentation on behalf of your clients to the Criminal Division before action is taken by the grand jury in this case.

In our view, the meeting you request would not be appropriate at this time. As you are aware prosecutive decisions in this matter are the responsibility of the United States Attorney for the Middle District of Pennsylvania, where the investigation is being conducted. Under the circumstances, presentations on behalf of your client or discussions concerning possible dispositions should be conducted with the United States Attorney's office. The United States Attorney, Mr. David D. Queen, has advised us that you, on behalf of your clients, will be afforded opportunities for such discussions and presentations well in advance of grand jury action in this matter.

For your information, it is our practice to consider the appropriateness of meeting with counsel only after matters have been fully concluded with the United States Attorney. Such a meeting would normally be limited to matters of policy and would not include evidentiary issues. For your information it is our normal practice in matters of this sort to require counsel to supply a written explanation of why such a meeting is necessary and a written submission of the points to be raised during the presentation.

Records
Section Chron.
✓Ogren
bcc: Jay B. Stephens, Stephen S. Trott, Victoria Toensing

you have any questions, please feel free to
rsigned.

Sincerely,

Robert W. Ogren
Chief, Fraud Section
Criminal Division

cc: Andrew M. Lawler, Esquire
Room 3001
220 East 42nd Street
New York, New York 10017

Loretta A. Preska, Esquire
Hertzog, Calamari & Gleason
100 Park Avenue
New York, New York 10017

Mr. Albert Murray, Jr.
Assistant United States Attorney
Middle District of Pennsylvania
1116 [illegible]
[illegible] 869
[illegible]
[illegible]

Al:

The Hundley meeting may be rescheduled for the morning of the 19th or the 21st. Hundley will let us know next week (early). They are apparently having a big pow wow in NYC on the 18th in the morning. I hope to have a draft civil injunctive complaint and injunction prepared by next Tuesday. I could not remember whether we have something scheduled for Tuesday in Harrisburg. Call me on Monday night and let me know---I'll be returning from Dallas at about 7pm. I'm set for the Castellano interview in NYC on Saturday: but let's make it for early in the morning, so I can get back to DC by 2 or 3pm. Where are you going to stay in NY? The enclosed letter (and some subpoenas) might be a good idea---send 'em out if you want to. It will keep the pressure on. If you need to reach me over the weekend, I'll be at the Loews Anatole Hotel, Dallas, [214] 748-1200. Ask for Sandy.

I'm sending this to Harrisburg and Scranton. One should reach you.

March 19, 1985

Memorandum to File: E.F. Hutton & Co., Inc.

Tom Curnin called at 5 o'clock this afternoon and advised me that he has been authorized to negotiate with us a disposition of the charges proposed to be brought against Hutton, which disposition would include a felony plea [which would not "cripple the company" in terms of its continuing to do business], a criminal fine, costs of prosecution, restitution and a civil injunction. They are proceeding with the creation of a committee of the Hutton board which will have authority to ratify any agreement we make. Curnin et. al. will be here at 2pm on Thursday, March 21st to begin negotiating. I have called Murray and advised him of Curnin's call.

Peter B. Clark

t: 3/27/85

RWO:JPC:PBC:emm
36-63-157

MAR 27 1985

Thomas F. Curnin, Esquire
Cahill, Gordon & Reindel
80 Pine Street
New York, New York 10005

Re: E.F. Hutton and Company, Inc., et. al.

Dear Mr. Curnin:

Enclosed please find draft copies of a plea agreement, and various consents and final judgments of permanent injunction in the captioned matter. We expect to have available for you, by the close of business today, a draft civil injunctive complaint. These drafts are, of course, submitted to you for the purposes of negotiation only.

Sincerely yours,

Robert W. Ogren
Chief, Fraud Section
Criminal Division

Records
Section Chron.
Clark/2

By:
Peter B. Clark
Trial Attorney

Enclosures

cc: William G. Hundley, Esquire

Noted
RWO

Memorandum to File April 1, 1985.

E.F. Hutton Group, Inc.

A

I received a telephone call at home at 9pm yesterday evening from Tom Curnin. On Friday, I had asked Curnin to call me no later than 5pm on Sunday with the company's decision on the guilty plea to mail and wire fraud charges. The reason for the deadline was to give us enough time to warn Al Murray and John Holland so that they could avoid making the trip down here in the event the company was not going to bite the bullet on mail and wire fraud. Curnin said that he had discussed the matter with the company's outside directors and that they were agreed "hypothetically" to enter pleas to mail and wire fraud, but would not actually agree until they had examined the information. When I attempted to ascertain whether this response met our pre-meeting requirements, including whether he meant a guilty plea, nolo, etc., Curnin hung up.

CAHILL GORDON & REINDEL
EIGHTY PINE STREET
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*ADMITTED D.C. ONLY
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April 2, 1985

Re: In re Grand Jury Investigation
E.F. Hutton & Company Inc., et al.
Index No. 82-0196

Dear Mr. Ogren:

Enclosed for your review and consideration is our revision of the Plea Agreement we discussed yesterday. We have not yet completed our review of the Government's proposed formula which is referred to as Schedule 1 in the enclosed draft. I hope to have our suggested version available later today.

As with previous submissions, this document is being submitted in connection with plea negotiations pursuant to Fed. R. Evid. 410 and Fed. R. Crim. P. 11(e)(6). We further request that this plea agreement be treated as confidential for purposes of the Freedom of Information Act.

Very truly yours,

Thomas F. Curnin

Robert W. Ogren, Esq.
Chief, Fraud Section
U.S. Department of Justice
315 9th Street, N.W.
Washington, D.C. 20006

[Enclosure]

BY HAND

cc: Peter B. Clark, Esq.
Albert R. Murray, Jr., Esq.

440

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WRITER'S DIRECT NUMBER
(212) 701-3609

April 18, 1985

Re: In re Grand Jury Investigation
E.F. Hutton & Company Inc., et al.
Index No. 82-0196

Dear Bob:

Enclosed are the drafts of the Information, Plea Agreement and Complaint which you forwarded to us on Monday, and Exhibit C which came in yesterday. I have reviewed these documents and marked on each my suggested changes.

I need to discuss these changes with you and reach final agreement by tomorrow afternoon.

I understand that other drafts came in yesterday on consents, etc. but I have not reviewed them but for Exhibit C.

Sincerely,

Tom Curnin

Thomas F. Curnin

Robert W. Ogren, Esq.
Chief, Fraud Section
U.S. Department of Justice
315 9th Street, N.W.
Washington, D.C. 20006

[Enclosures]

cc: Peter B. Clark, Esq.
Albert R. Murray, Jr., Esq.

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WRITER'S DIRECT NUMBER

(212) 701-3609

April 19, 1985

Re: In re Grand Jury Investigation
E.F. Hutton & Company Inc., et al.
Index No. 82-0196

Dear Bob:

Enclosed are revisions to the Information, Plea Agreement and Complaint discussed today.

1. Information: I have enclosed revised pages 1, 5 and 6. All other changes in our draft of 4/18/85 are to be incorporated in the final version.

2. Plea Agreement: I have enclosed revised pages 2, 3, 9 and 10. All other changes in our draft of 4/18/85 are to be incorporated in the final version.

3. Complaint: I have enclosed revised pages 2, 7, 11 (where we have not yet resolved how to treat the question of affiliates because of the problem with what is meant by "operating affiliates" and "actual control"),

13 and 14. All other changes in our draft of 4/18/85 are to be incorporated in the final version.

Sincerely,

Thomas F. Curnin

Robert W. Ogren, Esq.
Chief, Fraud Section
U.S. Department of Justice
315 9th Street, N.W.
Washington, D.C. 20006

[Enclosures]

cc: Peter B. Clark, Esq.
Albert R. Murray, Jr., Esq.

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FREDDY DRESSEN ***
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CHARLES F. OETMAN, JR.
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*ADMITTED D. C. ONLY
**ALSO ADMITTED ENGLAND AND JAMAICA
***ADMITTED FRANCE ONLY

WRITER'S DIRECT NUMBER
(212) 701-3609

April 23, 1985

Re: In re Grand Jury Investigation
E.F. Hutton & Company Inc., et al.
Index No. 82-0196

Dear Peter:

Our draft of Exhibit B is enclosed.

Sincerely,

Thomas F. Curnin

Thomas F. Curnin

Peter B. Clark, Esq.
U.S. Department of Justice
Federal Triangle Building
315 9th Street, N.W. - Room 826
Washington, D.C. 20530

[Enclosure]

BY HAND

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NEW YORK, N.Y. 10005

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WRITER'S DIRECT NUMBER

(212) 701-3609

April 25, 1985

Re: E.F. Hutton & Company Inc.

Dear Mr. Clark:

Please be advised that we have reviewed the Government's drafts dated April 24, 1985 as amended by the revised pages sent to us on April 25 and, with the exception of three minor changes, find the resulting revised draft to be acceptable in all respects. Moreover, Company management has likewise reviewed and approved these drafts, as reflected by the signatures of Messrs. Pierce and Lynch hereon.

Company management will submit these drafts to the Board of Directors of Group and Inc. for approval and management expects that such approval will be forthcoming.

Very truly yours,

Thomas F. Curnin

Thomas F. Curnin

Peter B. Clark, Esq.
  Trial Attorney
Criminal Division
United States Department
  of Justice
Federal Triangle Building
315 9th Street, N.W.
Room 826
Washington, D.C. 20530

CONSENTED TO:

THOMAS B. LYNCH
President
E.F. Hutton Group Inc.

SCOTT PIERCE
President
E.F. Hutton & Company Inc.

cc: Albert R. Murray, Jr., Esq.
William G. Hundley, Esq.
Thomas W. Rae, Esq.

Bob:

Attached are the Complaint and the Information. The Plea Agreeement and Exhibit "C" are redone, but waiting word that Curnin and Murray have agreed upon the language of the bank expense reimbursement clause. I placed several calls to Curnin during the day, but he returned none of them. I finally reached him at 4pm and reviewed briefly with him the major changes. He said he would call Murray immediately on the bank expense matter, but had not done so by 7pm. On the complaint we have two major unresolved problems: 1] Curnin says that his language "Hutton Group is named a defendant in order to ensure complete and effective relief against the acts complained of herein." is final, a deal-breaker and that the directors won't sign unless it's in. I doubt seriously whether the board will go to trial over the absence of this sentence, but I don't think it is as serious a problem as Curnin's second "deal-breaker". 2] is that Curnin insists that Wherefore para. "2" contain nothing about "disbursements" and must be his language. He cannot, or will not, give any other explanation than to say that "disbursements" were not "part of the deal". Again, I don't think they will go to war over this, unless we are missing something of great import in this language.

Two other matters. Curnin is now flinching at the 2,000 counts. I really think we are setting ourselves up for criticism if we tried to retroactively apply the jumped-up fine provisions. Why put ourselves in the position of having to explain an otherwise illegal sentence, and risk a post-plea motion, just to make it look better for Hutton. They agreed to the 2,000 counts and let's hold them to it.

We should also consider seriously giving Curnin another deadline. I suggest that we tell him tomorrow morning that we, the lawyers, should agree upon all the language by the close of business on Wednesday. We are very close, and there is nothing to bar working out the very minor remaining points. If Curnin balks, then I believe we should tell him that we consider them to be stalling. Curnin can present the papers to the Board on Thursday and the Board can give an up or down decision. If it's down, then Curnin should understand that we will not negotate further. Curnin has to know that we will indict, even if you and I know that that is not the optimum set of circumstances. If Curnin thinks he can come back from the Board meeting and bargain some more, then we will really be up against the time barrier as far as indictment is concerned. Murray and I will have little more than a month to put an indictment together and prepare for motions and trial; I personally do not want Curnin bargaining while I am doing that, because we will not get any cooperation from the company in finishing the grand jury presentation. They have amply demonstrated that already, over the past month.

U.S. Department of Justice

United States Attorney
Middle District of Pennsylvania

EXPRESS MAIL

Post Office Building
Washington & Linden Streets
Scranton, Pennsylvania 18501

717/348-2800
FTS/592-8301

March 5, 1985

Thomas F. Curnin, Esquire
Cahill, Gordon and Reindel
80 Pine Street
New York, NY 10005

RE: Grand Jury Investigation
E.F. Hutton and Co., Inc., et al
No: 82-0196

Dear Mr. Curnin:

Enclosed herein please find the following Grand Jury Subpoenaes:

[redacted] Our office acknowledges and appreciates prompt production of documents once they are in your possession. Our great concern is your client's failure to produce critical Grand Jury evidence. It is becoming quite

Thomas F. Curnin
Page 2
March 5, 1985

apparent that your client is attempting to intentionally thwart the Grand Jury's investigation. Our inventory of records and my own personal review of our files indicates that we have not previously received the

Moreover, we have recently obtained information that this document, as well as others, may have been intentionally destroyed as a direct result of the Grand Jury's investigation. Tom, as you know, this is a serious matter and must be addressed.

We expect to receive all documents kept within the normal course of business, including

No further extensions of time will be granted.

Thank you very much.

Yours very truly,

JAMES J. WEST
United States Attorney

ALBERT R. MURRAY, JR.
Assistant U.S. Attorney

JJW:ARM:jak
cc: Robert W. Ogren, Esquire
Chief Fraud Section
U.S. Dept. of Justice
Criminal Division
Washington, D.C. 20530

John Holland

Peter Clark

CAHILL GORDON & REINDEL
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*ADMITTED D.C. ONLY
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WRITER'S DIRECT NUMBER

(212) 701-3609

March 12, 1985

Re: In re Grand Jury Investigation
E.F. Hutton & Company Inc., et al.
Index No. 82-0196

Dear Mr. Murray:

I am in receipt of your letter of March 5, 1985 and the attached subpoenas.

As you are aware, the Company incurred a great deal of time, effort and expense in complying with the Grand Jury subpoenas dated May 10, 1982. Indeed, due to your insistence that the Company respond to the subpoenas as drafted, with only slight modifications, compliance was tremendously complicated and resulted in the production of millions of documents at a tremendous cost to the Company. If it should develop that, through inadvertence, compliance with these subpoenas was not complete in every respect, that would not demonstrate lack of cooperation or good faith compliance with these subpoenas, especially given the tremendous burden which compliance placed on the Company. Moreover, as we have repeatedly told you, non-regulatory records of routine occurrences were not normally maintained by the Company. Indeed, certain of the records produced from time to time subsequent to the Company's response to the subpoenas came from personal files that had not previously been believed to contain responsive materials. On this record, your conclusion that the Company "is attempting to intentionally thwart the grand jury investigation" is simply not justified. As you have from time to time in the past felt free to inform me that, in your view, lawyers and witnesses have not been cooperating, I can only assume that if there was any substance to your claim, you would have long since apprised me of it. As you are aware, whenever material responsive to your subpoenas was uncovered, the Company produced it.

On a wholly different note, however, is your very serious charge about document destruction. I know of no information that would support such a charge or your contention that [redacted] "may have been intentionally destroyed" as a result of the grand jury investigation. If you believe you have any information to the contrary, I think you are under a duty to apprise me of it so that we may review and evaluate this claim.

As for the grand jury subpoena dated [redacted] our respective positions are fully set forth in the letters exchanged between you and us dated May 8, 1984, May 17, 1984, July 25, 1984, July 27, 1984 and August 8, 1984, and our subsequent conversation in Harrisburg confirming that compliance with that subpoena was adjourned pending the outcome of your efforts to narrow the subpoena.

As you are fully aware, the Company is unable to comply with the [redacted] subpoena addressed to the Custodian of Records by March 15, 1985 and, indeed, such a request at this time is exceedingly burdensome and unnecessary and, therefore, I believe that it would be in our mutual best interests to discuss the scope of this subpoena which I can do at your convenience.

Sincerely,

Thomas F. Curnin

Thomas F. Curnin

Albert R. Murray, Esq.
Assistant U.S. Attorney
U.S. Department of Justice
Middle District of Pennsylvania
Post Office Building - Room 426
Washington & Linden Streets
Scranton, PA 18501

VIA FEDERAL EXPRESS

cc: Robert W. Ogren, Esq.
Chief, Fraud Section
U.S. Department of Justice
Criminal Division
Washington, D.C. 20530

William G. Hundley, Esq.
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Dilworth, Paxson, Kalish & Kauffman
2600 The Fidelity Building
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Thomas Fitzpatrick, Esq.
80 Pine Street - 31st Floor
New York, NY 10005

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WRITER'S DIRECT NUMBER
(212) 701-3609

March 19, 1985

Re: In re Grand Jury Investigation
E.F. Hutton & Company Inc., et al.
Index No. 82-0196

Dear Mr. Murray:

Further to our conversation last week, enclosed herewith please find a copy of the notice that was sent to the branch offices and regions today to collect the material identified.

Sincerely,

Tom Curnin

Thomas F. Curnin

Albert R. Murray, Esq.
Assistant U.S. Attorney
Middle District of Pennsylvania
Post Office Building - Room 426
Washington & Linden Streets
Scranton, PA 18501

[Enclosure]

VIA FEDERAL EXPRESS

cc: William G. Hundley, Esq.
J. Clayton Undercofler, III, Esq.
Thomas Fitzpatrick, Esq.

463

Memorandum to: All Regional Vice Presidents
All Regional Operations Managers and
All Branch Managers

From: Thomas W. Rae,
Executive Vice President
and General Counsel

[redacted]

Your branch or region previously was required to collect and forward to a regional facility similar documents. This request will require a new search of all pertinent branch and regional files.

It should be emphasised that this memo requires a search and production from any source. It is not limited to central branch files; it includes any personal or private files, and it does not matter whether the documents are kept by office personnel, in your desk, in your home or elsewhere.

If you have any doubts about whether a given document comes within the scope of this memorandum send it to New York anyway.

No later than Monday, March 25, you must forward all such documents to Bob Brunton at New York Legal by Federal Express. At the same time you are required to complete and send to Mr. Brunton the attached certificate of compliance with this request, and wire Mr. Brunton that you have complied with these requirements.

The importance of strict compliance with this request cannot be overemphasised.

CERTIFICATION

To: Legal Department

Attn: R. Brunton

I hereby certify that I have compiled and forwarded to you

[redacted]

Branch Manager,
Regional Vice President, and
Regional Operations Manager

Office - Name and Number

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WRITER'S DIRECT NUMBER
(212) 701-3609

March 22, 1985

Re: In re Grand Jury Investigation
E.F. Hutton & Company Inc., et al.
Index No. 82-0196

Dear Mr. Murray:

Pursuant to my telephone conversation yesterday with you and Peter Clark, I am enclosing documents numbered 338726 through 329917. You may undoubtedly already have copies of many of them.

Sincerely,

Thomas F. Curnin

Albert R. Murray, Esq.
Assistant U.S. Attorney
Middle District of Pennsylvania
Post Office Building - Room 426
Washington & Linden Streets
Scranton, PA 18501

[Enclosures]

VIA FEDERAL EXPRESS

cc: Robert W. Ogren, Esq. (without enclosures)
Peter B. Clark, Esq. (with enclosures)

CAHILL GORDON & REINDEL
EIGHTY PINE STREET
NEW YORK, N.Y. 10005

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WRITER'S DIRECT NUMBER
(212) 701-3609

March 29, 1985

Re: In re Grand Jury Investigation
E.F. Hutton & Company Inc., et al.
Index No. 82-0196

Dear Mr. Murray:

I am enclosing herewith documents numbered 329918 through 331366 and documents numbered 332506 through 332527. You may undoubtedly already have copies of many of them.

Sincerely,

Thomas P. Curnin

Thomas P. Curnin

Albert R. Murray, Esq.
Assistant U.S. Attorney
Middle District of Pennsylvania
Post Office Building - Room 426
Washington & Linden Streets
Scranton, PA 18501

[Enclosures]

VIA FEDERAL EXPRESS

cc: Robert W. Ogren, Esq. - without enclosures
Peter B. Clark, Esq. - with enclosures

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WRITER'S DIRECT NUMBER
(212) 701-3609

April 9, 1985

Re: In re Grand Jury Investigation
E.F. Hutton & Company Inc., et al.
Index No. 82-0196

Dear Bob:

Enclosed are the redrafts of the proposed Plea Agreement, Information and Complaint received yesterday. I have noted our suggested changes directly on your drafts for ease of reference. Please let me have your comments as soon as possible so that the "final" drafts can then be reviewed with the Company.

Further, I believe that we have reached substantial agreement with Al Murray on the content of the restitution formula set forth in Schedule I.

Sincerely,

Tom Curnin

Thomas F. Curnin

Robert W. Ogren, Esq.
Chief, Fraud Section
U.S. Department of Justice
315 9th Street, N.W.
Washington, D.C. 20006

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[Enclosures]

cc: Albert R. Murray, Jr
William G.
Th

, Esq.

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WRITER'S DIRECT NUMBER
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April 9, 1985

Re: Grand Jury
(E. F. Hutton & Co.)

Dear Al:

Enclosed, as we discussed, is a redline draft of the restitution procedures, which reflects the changes we agreed on yesterday and today.

Sincerely,

EK

Edward P. Krugman

Albert R. Murray, Jr.
Assistant U. S. Attorney
Federal Building
Third & Walnut Streets
Harrisburg, PA 17108

(Enclosure)

VIA FEDERAL EXPRESS

cc: Thomas F. Curnin, Esq.
Thomas J. Kavaler, Esq.

April 26, 1985

Bob:

I returned Bill Hundley's call. He said that he had spoken with Curnin this morning and that the Board is now scheduled to meet late on Tuesday and that Curnin is planning to do the Rule 11 on Thursday. The call was cordial, Bill was just passing on information he received from Curnin.

Kavaler, Curnin's partner, called in response to my several calls to Curnin between 9:00 a.m. and 10:30 a.m. According to Kavaler, "Bob Ogren told Hundley that either Monday or Thursday (of next week) were equally acceptable" and therefore, Curnin scheduled the Board meeting for Tuesday and is planning on Thursday as the day of the plea. He could offer no explanation of why Curnin was unable to return my calls between noon and 10:00 p.m. yesterday. Kavaler said that Curnin had prepared a letter, to be signed by Curnin, Lynch and Pierce, confirming that the papers were acceptable to them, and that they will recommend that the Board accept the settlement. He wants us to file the information, etc. and show the letter to Judge Nealon. I told him (1) that we clearly understood that the Board was meeting today, not next Tuesday; (2) that it would be extremely inconvenient for you to leave the Boston [illegible] to be in Scranton next Thursday; (3) that I would never recommend filing the information without having a signed plea agreement in hand. Kavaler was acting strictly as a messenger for Curnin and I asked that Curnin call us immediately.

Between the two of us, I am not wholly opposed to doing this next Wednesday, or if necessary, early on Thursday, if Murray will prepare a written offer of proof. We could start today, and finish it up here on Monday and Tuesday. It would help focus Al's allocution and really provide a factual basis for Judge Nealon's taking the plea, in case the allocution becomes a tad esoteric.

What do you think?

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA,

v.

E. F. HUTTON AND COMPANY, INC.,

Defendant.

CRIMINAL NO. 85-00083

BEFORE: HONORABLE WILLIAM J. NEALON,
Chief Judge,
United States District Court,
For the Middle District
of Pennsylvania,
Pre-Trial Conference,
at Scranton, Pennsylvania,
on, Tuesday, April 30, 1985.

APPEARANCES:

FOR THE GOVERNMENT: ALBERT MURRAY, ESQ.,
Assistant United States Attorney,
Scranton, Pennsylvania

PETER B. CLARK, ESQ.,
United States Department of Justice,
Criminal Division,
315 9th Street, N.W.
Washington, D.C.

FOR THE DEFENDANT: CAHILL GORDON & REINDEL
BY: THOMAS F. CURNIN, ESQ., &
THOMAS J. KAVALER, ESQ.,
80 Pine Street,
New York, New York

APPEARANCES CONTINUED:

THOMAS FITZPATRICK, ESQ.,
80 Pine Street,
New York, New York

HUNDLEY and CACHERIS, P.C.,
BY: WILLIAM G. HUNDLEY, ESQ.,
1914 Sunderland Place, N. W.,
Washington, D.C.

DILWORTH, PAXSON, KALISH &
KAUFFMAN
BY: THOMAS I. VANASKIE, ESQ.,
Penn Security Bank Building,
Scranton, Pennsylvania, and
BY: J. CLAYTON UNDERCOFLER, III, ESQ.,
2600 The Fidelity Building,
Philadelphia, Pennsylvania

(In Chambers.)

THE COURT: Well, I'm going to have this transcribed, and proceed with it.

MR. MURRAY: Good evening, your Honor.

THE COURT: All right.

MR. MURRAY: Your Honor, for the past three years, and I would say technically since April the 14th, 1982, a Grand Jury that's been sitting in Harrisburg, Pennsylvania, and I believe the number is 83-142, has been conducting an investigation into certain violations of Title 18. And specifically mail fraud and wire fraud, involving certain defendants, one of those being E. F. Hutton Group, Inc., and which is a parent company for E. F. Hutton Company, Inc., two Delaware Corporations, which are conducting business in New York, and who are registered, at least the group, registered broker/dealers. Also the Grand Jury has been investigating other persons and syndications involved with those two companies.

As a result of this investigation, and the Grand Jury is still sitting, we have had, the government, that is, represented by the Criminal Division, United States Department of Justice, and specifically the Fraud Section, along with our office, we've entered into certain discussions with the company, that is, E. F. Hutton Group, Inc., and E. F. Hutton and Company.

As a result of our discussions, and those have been

READEX FICHE

in the nature of plea bargain discussions, we have entered into, today, as a matter of fact, a tentative plea bargain agreement under Rule 11(e)(1)(C), I believe it is, subject to the Court's approval.

This agreement, basically, would include a situation where --.

THE COURT: How long an agreement is it in length?

MR. MURRAY: In length? I think the actual plea bargain agreement -- the information is approximately eight pages, and the plea bargain agreement is approximately 20 pages.

MR. CURNIN: Under 20 pages, your Honor.

THE COURT: 120 pages?

MR. CURNIN: No, under.

THE COURT: Oh, under.

MR. CURNIN: I can give you the exact number, Judge.

THE COURT: No, that's close enough, fine.

MR. MURRAY: Generally, your Honor the plea agreement calls for an information to be filed by the United States Attorney's Office, against E. F. Hutton and Company, Inc., only, the broker/dealer --

THE COURT: E. F. Hutton and Company?

MR. MURRAY: Inc. It's the broker/dealer only. The information would be regarding charges alleging violations of 18 United States Code, Section 1341, which is mail fraud, 18

United States Code, Section 1343, which is wire fraud. The information would contain 2,000 counts. 100 of those counts would be involving the mail fraud violations, and 1900 of the counts would involve wire fraud violations. This would be for a period basically between July of 1980 and February of 1982. I ve left out the specific dates.

The information revolves, and the charges revolve around a scheme to defraud various financial institutions throughout the United States, by Hutton, through the intentional overdrafting of its bank accounts, both at a local level, which services its branches; at a regional level, service centers, which have regional banks to concentrate funds; and also at its headquarters, and the prime concentration of banks there.

As a part of this plea bargain agreement, part of the information -- excuse me, the information, as I've said, does not charge any individuals and it's only against the corporation.

The plea bargain agreement also calls for the company, Hutton and Company, to plead. Actually, to enter guilty pleas to those charges. And it also calls for the company to pay a fine of $2,000,000.00 to the government, and to pay $750,000.00 in costs.

Included in the --

THE COURT: Is the government the victim?

MR. MURRAY: The government is claiming that -- excuse me, your Honor.

THE COURT: You know, the victim impact statement.

MR. MURRAY: We believe that the Federal Reserve System was affected by the activity, and also that the various commercial banks, approximately 300 to 400 banks were affected. What we've done is, we have a provision in the plea bargain agreement for restitution to be made by E. F. Hutton and Company, in the event the Court accepts this agreement, to all the various commercial banking institutions that would be affected by the scheme during this period of time, between July of '80 and February of '82. We've set up a provision in the plea agreement for the company to provide, one, notice of the proceedings to all commercial banks that the company maintained a depository relationship for this period of time.

THE COURT: Notice of what?

MR. MURRAY: Notice of the charges, notice of the plea bargain agreement, and notice of the fact that they would be entitled to restitution if they could sustain a claim regarding this period of time.

THE COURT: Who determines the validity of the claim?

MR. MURRAY: That would be determined by a Special Master, that we've also set up provisions for, according to a formula for restitution, which was jointly produced by Hutton

Company and also the government. This formula generally calls for the affected bank, or victim, to be reimbursed for any uncollected position or losses sustained as a result of this activity.

THE COURT: But none of them have been consulted up to this point?

MR. MURRAY: No, your Honor, none of the banks are aware, as I understand, at least today, of this proposed plea bargain agreement, or the restitution agreement, which is a part of that. The restitution agreement would call for the banks, the affected banks to, in fact, file a claim, if they felt that that was proper, making a claim for any losses.

And then, if there was a dispute, the Special Master would be the person to settle the dispute. We have provisions in this agreement for the company, Hutton, to resolve any disputes on an amicable basis, if, in fact, that's appropriate. And that the Special Master would only be involved in the event that there was a dispute as to the claim.

THE COURT: Is the Special Master designated?

MR. MURRAY: The Special Master, in the proposed agreement, hopefully would be agreed upon, a person, by Hutton, the Defendant, and also the government.

In the event that we could not agree jointly within 30 days, the agreement calls for the Court to appoint a Special Master, based upon a list of persons that would be submitted by

Hutton and also by the government. There are also various time frames within the agreement, the restitution agreement for the, one, as I've said before, the appointment of a Special Master, notice to be given to all the affected parties by the company.

THE COURT: I don't like to keep interrupting you, but --

MR. MURRAY: That's all right.

THE COURT: But is the Special Master's determination final?

MR. MURRAY: No. It can be, in some limited circumstances, can be reviewed by the Court.

MR. CURNIN: Your Honor, for all intents and purposes, it please the Court, my name is Thomas Curnin, representing the Defendant, Hutton Group and Hutton, Inc.

The determination of the Special Master, we believe, for all practical purposes, will be final. There is only one avenue of review, and that is if it can be manifestly demonstrated that in resolving the claim the Special Master did not follow the formula, and did not apply the formula that has been agreed to by the government and the defendants, and if it should be established that he had a conflict of interest at the time he rendered his determination.

But for that, the determination of the Special Master is final, and the restitution agreement also provides that all issues regarding time, or limited discovery that may be provided for in the plea agreement shall all be resolved with finality by the Special Master, and that we have no review, or no opportunity to take that up beyond the Special Master.

The procedure for restitution, your Honor, I'd also like to note, not only takes care of the claim that any bank may have, it takes care of interest, to date, that the claim is paid.

And also, your Honor, we have agreed to two things. First, to rely on the banks records, their analysis of the profitability of their accounts. And if they have done an analysis of their records, through their records of their dealings with Hutton, which they furnished to us at the time, that's binding on us. We don't have any opportunity to review --

THE COURT: How many banks are involved?

MR. CURNIN: The total universe of banks, your Honor, is approximately 400. In other words, between July 1, 1980 and February 28, 1982, the total universe of banks dealt with was 400. And so notice of this restitution program will go to each of those banks.

As I was saying, your Honor, we've agreed to be bound by the banks records, and in the situation where the bank doesn't have the records, we have agreed, in another formula, to reimburse them for the costs of creating the necessary records. So we believe that this restitution plan will provide for full compensation to the banks, plus interest, and it also provides a very expeditious procedure for them to make their claims and receive recovery through the vehicle of the formula that the government and we have agreed to, and the office of a Special Master.

MR. MURRAY: We've anticipated certain problems with a person unfamiliar with this type of activity, and it involves basically banking and finance, accounting, and it also may cross over into some securities law, and we set forth the procedure in the restitution agreement, where we have actual forms that we've drafted, for the claim for restitution. We have a notice format set forth, and we have a time period.

The time period, as I recall, in the event that the whole process were to extend to its entirety, is approximately 375 days. However, that would be the outside limits. But that would include the appointment of a Special Master, the request to, what we call a participate in the actual, for restitution or in restitution. There is a discovery period for the parties; there is provision for hearings, in the event that's necessary; and there's a provision for a period of time for final payment. And we think that what we've worked out is very equitable for the government, and also for the affected financial institutions.

THE COURT: Who has executed the plea agreement for the companies?

MR. CURNIN: The President of both Hutton, Inc., your Honor, and Hutton Group.

MR. MURRAY: Hutton Group is not a criminal defendant in the criminal action, information.

THE COURT: But it wholly owns Hutton and Company?

MR. MURRAY: Yes, your honor.

MR. CURNIN: And we have a resolution from both boards, your Honor, passed today, approving, in the case of Hutton, Inc., taking the plea, and in the case of Hutton Group, consenting to the entry of the injunction.

MR. MURRAY: Which we haven't discussed yet.

MR. CURNIN: No, it's a subsequent matter.

THE COURT: Who is executing it for the government?

MR. MURRAY: For the government, your Honor, the information has been executed by James West, United States Attorney, by Robert Ogren, the Chief of the Fraud Section of the Criminal Division of the United States Department of Justice.

THE COURT: Well, just so I'll get a feel for it. What's the highest level in the department at which this has been reviewed and approved?

MR. CLARK: The Assistant Attorney General in charge of the Criminal Division, your Honor, Steve Trott.

MR. MURRAY: Your Honor, I am also a signator to the contract, and also Peter Clark, to the information and all other documents.

MR. CURNIN: These agreements, your Honor, have been negotiated at some length with Mr. Murray in Washington, D.C., with Mr. Ogren, and, of course, we also met with Mr. Trott, who is a signatory to the plea agreement that Mr. Murray has described.

MR. MURRAY: And Mr. Clark.

MR. CURNIN: And Mr. Clark, of course, was with us during those negotiations.

THE COURT: Is Mr. Trott a career government employee?

MR. MURRAY: No, he's appointed. As I understand, he's appointed.

MR. HUNDLEY: He's a political appointee.

THE COURT: He's a political appointee.

MR. HUNDLEY: He used to be the United States Attorney in California. He was brought in.

MR. MURRAY: He's the head of the Criminal Division.

THE COURT: And who is on the other gentleman you mentioned?

MR. CLARK: Robert Ogren, your Honor. He's the Chief of the Fraud Section of the Criminal Division. He's a career prosecutor with the Department of Justice.

MR. MURRAY: Excuse me a minute, your Honor.

THE COURT: And he's career?

MR. CLARK: Yes, your Honor.

THE COURT: Would he be the highest career employee within the criminal division?

MR. CLARK: Mr. Ogren is the highest career person in the Fraud Section of the Criminal Division. The Fraud Section is one of the five or six operating units of the Criminal Division. He reports directly to Steve Trott, who is the — well, I'm sorry, he reports to a Deputy Assistant Attorney General, one of four in the Criminal Division, and, in turn, she reports to Stephen Trott. Her name is Victoria Toensing. She is not a career official of the department. She is also a political appointee.

MR. MURRAY: Your Honor --

THE COURT: Excuse me just a minute. But would the Chief of the Fraud Section, and those other four or five of equal status, be the highest career employees in the Criminal Division?

MR. MURRAY: Yes, your honor.

MR. CLARK: One of the four Deputy Assistant Attorney Generals in the Criminal Division is a career -- no, I'm sorry, two: Mark Richard and Jack Keeny.

THE COURT: Oh, Keeny.

MR. HUNDLEY: Keeny. He was there when I was there.

THE COURT: Yes, I remember Keeny.

MR. HUNDLEY: Yes.

THE COURT: Okay. I'm sorry I interrupted you.

MR. MURRAY: That's okay, judge. Does the Court have any other questions?

THE COURT: No, go ahead.

MR. MURRAY: The plea agreement also calls for some prophylactic measures to be taken on the part of the company. And that is, within certain time frames the company is to file with the Court certain affidavits indicating that it has held certain seminars, has instructed its company's employees and personnel in the practices that will be prohibited by not only the guilty plea, by the information -- the practices that are indicated in the guilty plea, but also by an attendant proceeding, which is a civil injunction which we'll, I guess, discuss in a couple --

THE COURT: Does the information spell out the modus operandi, if you will, of the overdrafts?

MR. MURRAY: Yes, your honor it has an introduction which sets forth basically the business purposes, and the manner and means in which the company sets forth its business practices; it gives --

THE COURT: What was the objective of it?

MR. MURRAY: Scheme to defraud, to obtain interest free loans from banking institutions.

THE COURT: From what?

MR. MURRAY: From banking institutions.

There is an object clause, object of the scheme; there is a manner and means of effecting the scheme and artific to defraud; and it lays out in very succinct manner the actual crime and how it occurred.

THE COURT: Could you give me an example so I can get a better grip on it?

MR. MURRAY: Basically the information, certain pertinent portions charge that the company, during this period of time, engaged knowingly and willfully in a scheme to overdraft its bank accounts and take advantage of the clearing times of checks, which are the overdraft checks, from one point destination to another, in order to delay the payments mechanism, in order to obtain the interest free money from thos overdrafts, to obtain bank funds, funds which were not generate in the ordinary course of the company's business.

Float abuse, sometimes it's generally called. There are other names, practices for it. There are several different permutations of the means and manners in which the scheme was effected during this period of time.

The company, in essence, generated interest free monies, and then provided incentives to certain employees in it field operations to do the overdrafting of its local branch accounts, and then its regional bank accounts, and later some o its prime bank accounts, through its draw-down system, which is a mechanism for the concentration of funds from local branch offices into regional concentration points throughout the country, to its prime location and concentration point in New York, and also there is another one in California.

And during this process there's a series of transfers of checks, transferring these funds from these locations. In that process there is float created by reason of a transfer instrument or check that was used. The company set forth on a scheme to create additional float, and to overdraft the bank accounts. And by creating this additional float, coupled with the actual overdrafts of the accounts, it delayed the check clearing times, and therefore increased the time that the company could then make interest off of the excessive drawing amounts.

THE COURT: Is there any reasonable estimate, at this point, as to the amount of restitution that might ultimately be involved?

MR. MURRAY: It may be millions, your Honor, ~~it may~~ be less. It will depend upon the financial institution. ~~It's~~ hard to determine the actual amount of restitution. I don't think we can.

MR. CURNIN: At one point during the discussions, and I suppose more than one point, we discussed what the universe would be here, your Honor. We're unable to say. There is no cap on the restitution. Whatever the claims are, plus interest, they will be paid. And E. F. Hutton and Company, Inc., certainly has the financial means to meet that claim.

MR. MURRAY: And we haven't questioned that, the company's ability to do that. We haven't requested that there be security put up by the company, or other collateral, or guarantee to be filed with the Court on these claims.

THE COURT: There are no individuals to be charged though?

MR. MURRAY: No, your Honor.

THE COURT: Why is that?

MR. MURRAY: Well, as the Court is well aware, this is a plea bargain agreement, and it's been negotiated in this way, but we feel basically, for the purposes of a plea bargain agreement, that the corporation benefitted from the activity; that there are some novel issues relating to the manipulation of bank accounts and creating float.

We feel that the plea bargain agreement, as is drafted, with the restitution to all the banks, especially during the period of time affected, adequately compensates, or will set forth the procedures that adequately compensate all the affected parties. We feel with the remedial provisions, whereby the company will be instructing its personnel throughout the country of these practices, procedures, and that will be stopped. That's satisfactory and that protects the interest of the United States.

We feel that the fact that the company is acknowledging the guilt in this matter will set forth maybe kind of a new dawn in the manner in which portions of corporate American does business. And we thing that's important, that this practice be stopped.

We feel that the fine that the company is paying is adequate, and the cost of prosecution, which therefore will mean the government will not bear any expense for this investigation. It's been long and lengthy. We feel that the trial of this matter would potentially last 18 months, maybe longer, because there are novel issues that we have, many documents in the case. And that really the relief we received in this matter is sufficient, it protects the interests of the United States.

THE COURT: Well, are you saying that there are individuals you could have charged, but that was part of the concession of the plea agreement; or are you saying that because of the novel questions, the individual culpability might be difficult to establish; or are you saying a combination of all, that the restitution and fine best serves the public interest?

MR. MURRAY: Well, I'd say possibly a combination, or in different percentages of all that you've mentioned, might be the proper answer in this situation. As the Court knows, a corporation is an unnatural person, and that the corporation acts through individuals. But, of course, we believe that the corporation benefitted largely from this activity, monetarily, and the activity has stopped. And there is an adequate means, at this point in time, to correct any harm, and that the appropriate disposition would be as we've negotiated.

THE COURT: Well, you said the government believes it's a fair plea agreement?

MR. MURRAY: Yes, it is.

THE COURT: Does that mean everyone concurs in it at all levels?

MR. MURRAY: I can say that our office, and at all levels of the government, we believe this adequately protects the interests of the United States.

THE COURT: You believe it's a good plea agreement?

MR. MURRAY: Yes, I do, your Honor.

THE COURT: Personally?

MR. MURRAY: I personally believe -- well, I don't get personally involved in any case, your Honor, but I believe since our office started --

THE COURT: You and Tom Vanaskie are the only two in the room I know, that's why I'm asking you.

MR. MURRAY: Well, since I started this matter, your Honor, I believe that taking all the circumstances involved, and all the issues involved, that I recommended this agreement. I think it's a fair and reasonable agreement and one that the Court should accept. And one, I believe, that can stand any criticism by the public, if the public should choose to make some, and I would defend it.

MR. CLARK: All counsel, your Honor, I think, agree, that the disposition that's proposed in these papers, is fair, and I believe Mr. Curnin will represent that the boards of directors of both of the affected corporations have agreed that this a fair disposition. And certainly all the officials within the department believe it's a fair disposition.

MR. CURNIN: That is our position, your Honor. The entity, E.F. Hutton and Co, Inc., that is taking the plea, recognizes that the activity, the specific activity that is charged in the information wasn't proper, and it recognizes its responsibility for the conduct that occurred during that period, and has therefore accepted the very serious responsibility of taking a plea to mail and wire fraud felonies, and paying this fine, and the high cost of prosecution.

And at the same time it recognizes that it has a responsibility to its banks, even those that are no longer doing business with the company. And it does not want to see those banks sustain a loss. And, therefore, it has entered into, with the guidance of the Justice Department, a restitution agreement. I think it's novel in this area, both in terms of it's completeness and also in terms of the ease with which the banks will be able to come forward and make a claim, and have it satisfied promptly. So that we would urge the Court, together with the Department of Justice, to accept the plea agreement.

MR. MURRAY: Your Honor, one important factor I think that maybe I did not bring up, and we haven't talked about it yet, is the civil action that is being filed along with this action. And that is, it's really a novel action under the new omnibus crime act, or whatever. It's filed under 18 U.S.C. 1345. And this action, as an injunctive action, sets forth other practices which are not reached in the information on the criminal proceeding. But it provides mechanisms, and I believe eight separate paragraphs, I may be off on my numbers on that, whereby the company will cease from conducting certain money management practices, and the management will be set forth. And I think it's very critical to the government's interest that the company agree to stop these practices, and they have.

I don't believe that there has been another case in the country that has expounded such preventive measures. For example, several of the paragraphs require the company to disclose its money management practices to various financial institutions across the country, and requires that either a written agreement or a consent be entered into between the parties before the institution of the practices as it affects the various banks. That is a critical provision and that's been agreed to by the company.

That will allow a disclosure of the manner in which these various accounts are being handled. And something that will aid not only the bank, but also the company in determining its overall money management policy as it relates to a bank, and also as it relates to corporations.

THE COURT: You mentioned, if I understood you correctly, something along the line of sending a message to the industry. Do you mean by that, that other companies might be engaged in similar practices?

MR. MURRAY: Our investigation has focused mainly upon E. F. Hutton and Company. However, during the course of investigation, we, of course, have stumbled across or come across certain other activity of other companies, which I am not at liberty to mention to the Court, but we believe that, yes, that similar practices may be going on today. Maybe not to the extent that Hutton and Company's were, but we believe that it's important that these proceedings be accepted by the Court in order to give that message to corporate American that the government considers these practices violative of the law, both criminally and also from a civil standpoint. We consider that part of the proceeding, that ancillary civil proceeding, very, very critical and important as an adjunct to the criminal proceeding.

THE COURT: Well, getting back to probably my first question. For victim impact purposes, even though you can identify certain victims, do you feel you would be in compliance with the statute by entering into a plea agreement and providing for after-the-fact relief for the alleged victims?

MR. CLARK: Yes, there will be full notice under the terms of the plea agreement, your Honor, there will be full notice to each of the victim banks of the proceedings that will have taken place. And Hutton, backed by its parent corporation, will make full restitution to each of the victim banks that can establish a claim. And therefore there will be no victim bank that will not be paid if it establishes a claim.

MR. MURRAY: We specifically have agreed in these documents, and I would say also that on behalf of the Cahill Gordon firm, Mr. Curnin and Mr. Kavaler are members of that firm, were very meticulous in drafting documents, which we've reviewed, and which were very specific and were very thorough in relationship to notice to the various victim banks, potential victim banks. And these notices also contain all the various documents that will be filed, or that would be filed of record.

THE COURT: But you're mentioning that it's in 11(e)(1)(C) --

MR. MURRAY: Yes, it is, your Honor.

THE COURT: -- which would provide for the specific penalty. And I'm just inquiring, under the statute isn't there supposed to be some input from the alleged victim before sentence is imposed?

MR. MURRAY: Well, your Honor, as this agreement is written, the maximum penalty, as per the charges of 2,000 counts, there will be the maximum penalty, at least we've provided for the maximum penalty in the plea bargain agreement, to the charges. That is, it would be a 2,000 count indictment. Mail fraud and wire fraud each carry with it $1,000.00 fines, as it relates to obviously a corporation. So therefore the maximum penalty would be $2,000,000.00.

We've gotten additional relief, in that the company has also agreed to pay $750,000.00 to reimburse the government for costs and expenses. So the maximum sentence would be appropriate and it would be a part of the plea agreement. I think that would satisfy the statute.

THE COURT: Okay. Well, we're here today because, that is, in camera, and correct me if I'm wrong, it's because you requested that we have a meeting --

MR. MURRAY: Yes, your Honor.

THE COURT: -- initially, before we did anything in open Court?

MR. MURRAY: Yes, your honor. Because of the sensitive nature of this case, and because of the various documents, and because of the fact that E. F. Hutton Group is a publicly held corporation, because this has been a very secret investigation, and we believe it to be important to have a meeting with the Court, especially in that there's an ongoing pending Grand Jury investigation, and any public disclosure of this matter at this time would probably be prejudicial not only to the government, in the event that the Court did not accept this 11(e)(1)(C) agreement, but also to the defendant. We thought it in the best interest of the government, and also the defendant, to have this hearing in camera.

And I believe Rule 6(e)(5), and Rule 6(e)(6) allows for a proceeding in camera in the event that disclosures of a Grand Jury investigation would jeopardize the public interest. And, if necessary, I'll file a motion to that effect, if the Court requests that.

THE COURT: Well, what you contemplate now is submitting the information and the plea agreement?

MR. MURRAY: That's correct. Your Honor, we contemplate submitting the information, the plea agreement with attachments, a complaint for permanent injunction, a consent in undertaking in relationship to that injunctive proceeding, and also a proposed order for the Court in relationship to the permanent injunction. The injunction itself would be all those documents, which would be filed at one time with the Court.

And I might indicate that if the Court recalls, during this afternoon, at the recess that the Court took during trial, the trial unrelated to this matter, Mr. Clark and I indicated to the court that we would probably ask that these documents be sealed.

THE COURT: Yes. So you asked to approach me at side bar.

MR. MURRAY: Yes, your Honor.

THE COURT: As I was about to undertake a recess, and you mentioned that, and I told you that my initial reaction was negative to it.

MR. MURRAY: That's correct, your Honor.

THE COURT: Because you're contemplating all of this being done within a certain time frame?

MR. MURRAY: We would like, your Honor, I hope the defendants would join in, I think they will, to have the Rule 11 proceeding at one time, sentencing at one time, all in one day. As opposed to having it separated, as far as the taking the plea and then sentencing. Because the plea agreement would call for, in the event that there was a successful guilty plea entered, that the maximum fine is included in the plea agreement, et cetera, and that all of the injunctive proceedings would start to take affect from that date?

THE COURT: I mentioned this to you at side bar.

MR. MURRAY: Yes.

THE COURT: What's the problem with just filing the information and the plea agreement in the Clerk's Office, and giving me a chance to look at it, and scheduling the matter then for Thursday?

MR. CURNIN: Your Honor, if we may, we think that there is severe potential prejudice to the Defendant, Hutton, Inc., if the papers are filed in the Clerk's Office not under seal, and for some reason, and we hope that there is no such reasonn, the Court should thereafter decide not to accept the plea agreement that has been negotiated between the defendant and thhe government. I think the prejudice to the defendant under those circumstances is very real.

Also, your Honor, we are a publicly held company, tradedd on the New York Stock Exchange. The plea to which the companny is taking is a very serious one, and that may well have impactt on the trading in the company's stock, and indeed it may have tto be suspended.

My concern, your Honor, is, that if this plea agreemsent, this information and the civil complaint and permanent injunction is on file becomes public, that that informaation is disclosed before there is a determination of how the Coourt will react to the plea agreement, there will be severe speculation in the stock of the company, and the shareholders of the coompany could be materially adversely impacted by the interimm concern and speculation as to what's going to happen in this sttock.

THE COURT: Even if it were only a 24-hour hiatus?

MR. CURNIN: Yes, because the wide swing that could occur there in the trading of the stock could occur in a matter of hourrs. And I believe that the interest of justice, and the interesst of the government can be served if the papers are under seal, and then if your Honor decides to accept the plea, then, of courrse, the papers can be filed on Thursday, when we appear in Court, on the record, to set forth the reasons why we join with the government in requesting your Honor to approve the plea agreement.

And the concern is, and I think your Honor can see it, should we file this, and your Honor for some reason doesn't approve it, we would be materially prejudiced, I think, in any trial situation in the Middle District. Because the company, pursuant to this plea agreement, has said X, Y, and Z, and it agrees to this, and it agrees to that, and it agrees to give notice to victim banks. And I think the prejudice there could not be rectified, your Honor.

THE COURT: Do you have a position?

MR. MURRAY: Your Honor, our position is, and it relates to mainly the Grand Jury. There's a Grand Jury currently sitting and scheduled to expire shortly, or terminate shortly. And in the event that the Court did not accept this agreement and it was made public, while I don't think it would prevent the Grand Jury from making a return, if requested in an appropriate situation, it may have some affect upon the Grand Jury, or at least the ability, or the desirabilty of the defendant to make some type of a motion.

THE COURT: I'm just wondering, hypothetically, if the Court does not accept the plea agreement, does that become public record, the plea agreement itself?

MR. CURNIN: No, your Honor, it would not. That is the reason why, your Honor, we respectfully request, that it be kept under seal until the Court makes its determination. Bill?

MR. HUNDLEY: In other cases where I've done this, your Honor, what the Court has done, this is in Virginia, and I believe once in the Southern District, is that the Court reviews all of the papers, and I remember one in particular where the Court did not go along. And the papers were just handed back, and went ahead with the trial later on with no publicity.

In the cases where they're accepted, they do a lot of this in the Western District of Virginia, I guess, in Alexandria. The Court takes the papers, reviews the papers, perhaps gets us all back in here tomorrow. You might have some additional questions and things like that, and then when your Honor reaches a decision, let's assume the decision is to take the plea, and files the papers basically at the time the plea goes down. That has been the practice down there, sir.

THE COURT: Well, are you telling me that you have had experience in cases similar to this, where the Court has --

MR. HUNDLEY: Not of this magnitude, Judge, but we did this in Alexandria with another company, EATSCO. There was some publicity connected with the case. We pled the corporation, we pled the principal. We submitted documents, not as lengthy as this to the Court, but along the lines, you know, the same lines. It was a lot of restitution; there were big fines; and, you know, different things. The company agreed to be liquidated and everything like that.

And Judge Williams had some concern about it. He took the papers for a couple of days, brought us back, asked us questions, but finally agreed to accept the Rule 11; filed the papers at the time the plea went down.

THE COURT: Nothing was filed prior to that?

MR. HUNDLEY: Nothing was filed prior to that. And that was with the concurrence and recommendation of the government. The same concern that, you know, it might not fly. And the EATSCO case involved overbilling of the Defense Department and things of that have nature. It was somewhat sensitive.

THE COURT: Well, supposing I review it and decide I am going to accept it. What concerns me, and it should be obvious, I think, is that it looks like kind of a back room arrangement. That suddenly, without any notice, everyone appears in Court, under the type of an agreement, if the Court accepts, the sentence is finalized, and it may give the appearance of a cloud over the whole matter.

MR. HUNDLEY: I don't see --

THE COURT: Do you see any problem with that?

MR. HUNDLEY: No, I can appreciate the Court's concern, but under the Rule the Court would be entitled to, you know, obviously a reasonable period to study all of these documents, without any filing. Because if the Court agrees to the Rule 11, once you agree then you're bound by all of this.

THE COURT: I know.

MR. HUNDLEY: So certainly to that extent I think that would be understood, that you would have a reasonable period of time to study these documents, to ask questions of the attorneys, the government, defense counsel.

THE COURT: All in camera?

MR. HUNDLEY: Yes, sir. That's where we did it in the EATSCO case, yes, sir. Yes, sir.

MR. CLARK: And, your Honor there have been innumerable instances when even a complicated plea has been filed, and heard, and a Rule 11 proceeding take place on the same day, or immediately as soon as the Court's available. That is, I'm sure, Mr. Hundley's experience down in the District Court in the District of Columbia. It's been my experience in District Court's across the country.

And there there is, in effect, no notice to the public of the filing of the papers, the proceeding.

THE COURT: Are you talking about 11(e)(1)(C) --

MR. CLARK: Yes, your honor.

THE COURT: -- situation?

MR. CLARK: I'm sure Mr. Curnin has had experience.

MR. CURNIN: Your Honor, I think that on the face of the papers, and the information and disposition that you'll see in these papers, I believe, and I believe the government joins with me in this, that the agreement is more than eminently fair to any potential victim, and in the interest of justice, in that the maximum fine's being paid, the cost of prosecution in toto is being paid, full restitution is being agreed to, interest is being agreed to be paid, and under an expedited, and I think working with the government, somewhat novel procedure, to be sure that it's done very fairly, through the victims books, in a very expedited manner.

And at the same time recognizing that the government feels that further disclosure should be made to banks about the way in which a company such as ours deals with the banks, and indeed that the federal government may wish to use that in other areas with other companies, we have agreed to enter into the consent in regard to the civil complaint, and have agreed to conduct our banking business in certain specified ways in the injunction.

I think that this not only addresses and meets the government's claims under 1341 and 42, but goes beyond that. This was a problem. We regret it. And at the same time we're going to go recognize it and we're going to cure it.

You will see from the papers, your Honor, that the procedures set up for the banks is a very simple and direct one. The forms that they have to fill out are from their own books and records. The latitude, in fact almost total control that we've given to the Special Master to make a determination here, is almost complete.

I agree with Mr. Murray that the outside is 300 some odd days, but the procedures can be shortened to half that. Quite frankly, your Honor, and I think you'll see this from the plea agreement and the forms, our aim here is to have the banks come in and make their claims. We want the banks to come in. We want to see the claims discharged. To be in business we need the support of the banks. If the bank has been injured, we're saying, mea culpa, come in, make your claim, and we'll discharge it.

MR. MURRAY: Was the Court's question, and I don't mean to imply that I can read the Court's mind. Obviously you know I can't, Judge. But was the Court's question that in the event that you do decide to accept the plea, would that resolve the problem that exists now as to the sealing of the papers, is that what the Court was getting at when it asked its last question?

THE COURT: I don't follow you on that.

MR. MURRAY: I believe your last question was, what if the Court decided to accept the 11(e)(1)(C), would that then resolve the problem of sealing the information?

THE COURT: Well, it would be unsealed, wouldn't it, if I did? The only reason you're asking me to seal it is because you don't know whether I'm going to accept it?

MR. MURRAY: That's correct.

THE COURT: If I accept it, that ends the reason for the sealing.

MR. CURNIN: That's correct, your Honor, and what we would request, respectfully, if it meets the Court's schedule, and the Court agrees with us on the desirability and the reasonableness of the plea agreement, is to hear us on this on Thursday. And if the Court agrees, to file the papers, and to hear us in open Court, and accept the plea, and impose the fine, and enter the order on Thursday.

THE COURT: To hear you on what?

MR. CURNIN: Well, to the extent your Honor has any questions that your Honor wishes to put on the record in open Court, that --

MR. MURRAY: The Rule 11 would have to be in open Court?

THE COURT: Certainly.

MR. CURNIN: That would be appropriate, and required, and in open Court, and on the record.

THE COURT: If on looking at the papers I decide I'm not going to accept it, we wouldn't go into open Court.

MR. CURNIN: That is correct, your Honor, that would be severely prejudicial to us.

THE COURT: I'd advise you of that before hand. The only other thing, I have to rely significantly on the representations of government counsel here. And you've been into this for some time now. Do you agree with defense counsel that public notice of this before actual acceptance by the Court, and inherent in the acceptance under 11(e)(1)(C) is disposition, could cause a chaotic market condition?

MR. CLARK: The government, your Honor, is not in a position to give an opinion with respect to the effect of public disclosure, prior to the acceptance of the plea, on the market, or the trading in Hutton stock. Only Hutton, I think, can give the Court advice on that subject. Certainly the magnitude of this case is such that reporting of the case in the media will be extensive. And to what extent that there is reporting of this event in the media, there will be at least the opportunity for an unsettled condition in the trading of the company's stock.

THE COURT: If, assuming your timetable is valid and acceptable, and that the plea agreement would be accepted on Thursday at an in Court public proceeding, what impact would that have?

MR. CURNIN: Well, your Honor, I think it may, but at that point in time, and I'm thinking now about our shareholders, the impact is known; the company has taken a plea; it has been charged with X and Y during a specific period of time; here's what it paid in terms of a fine, cost of prosecution, and it has agreed to restitution.

The situation that would exist when that has not yet been determined, but these charges are on file, and at that point in time nobody knows what's going to happen. Is there going to be a long trial; what will be the outcome; what will be the Court's determination; what will be the sentence? Your Honor, the speculation there will be rampant.

MR. CLARK: That's the difference, your Honor, between certainty and uncertainty.

MR. CURNIN: We know on the one hand, and we don't know, and indeed the trading public does not know what's going to happen on the other. And we're talking here about an industry which is a volatile industry, with tender offers for brokerage firms, this, that and the other thing. There could be a lot of speculation here, your Honor, which would be, I think, unwise and, indeed, unnecessary.

THE COURT: Your Grand Jury investigation has taken a long period of time. Has there been gossip, or rumors, or --

MR. CLARK: None.

MR. HUNDLEY: None.

MR. CURNIN: Remarkable, it's a credit to the prosecutor, sir.

THE COURT: To the Grand Jury system, the secrecy of the Grand Jury system?

MR. MURRAY: Well, for the past three years we have had only one report of this case, and that was as a result of a disclosure made, I believe last year, by Hutton in its 10K disclosure form, and was picked up by the press. But there have been absolutely no other leaks of this Grand Jury investigation to anyone in the past three years.

And, as a matter of fact, the Grand Jury's investigation, we've subpoenaed over 300 witnesses; we've taken extensive testimony throughout the country from hundreds of people; and we just haven't had any leaks.

THE COURT: Assuming acceptance, who is going to appear in Court and enter the plea on behalf of the corporation?

MR. CURNIN: Your Honor, we believe it will be the Senior Executive Vice-President of Inc., a man by the name of Robert Whitt, who will be in Court to take the plea for the corporation, and he has been authorized and was authorized this morning by the board of directors.

THE COURT: Is he second in --

MR. CURNIN: He's probably the number three man, your Honor, in charge of national sales for E. F. Hutton, Inc.

If I may add one other point, your Honor. The Court expressed some either reservation or concern about how would this appear if its being done this way, and would there be some suggestion that there was some cloud here.

I don't believe so, your Honor, because we have a situation where the maximum is being imposed upon this defendant. It's not half way; it's not 70 percent; it's not almost there; but it's the maximum: Both in terms of fine, cost of prosecution, and full restitution, plus interest.

MR. MURRAY: Maybe there should have been leaks, then it wouldn't have been so --

MR. CURNIN: On that particular point I'd like to join with Bill Hundley. Most of my practice, your Honor, is in the Southern District of New York. And we have a little difficulty up in the Southern District of New York in keeping proceedings quiet, or at least as quiet as we who represent defendants would like.

This has been a long investigation involving, I believe, a lot of people. I know a lot of our people have been present. And Mr. Murray, who's handled it primarily, and Mr. Clark, and this district deserves a lot of credit for conducting such an inquiry and in such a professional manner that there were no leaks.

MR. HUNDLEY: We see another problem you have that started before when Mr. Curnin and I appeared before the full board of directors. One of them asked some question about, you know, whether or not the Court had to accept the plea, which they were authorizing.

Of course Mr. Curnin told them, "Yes." And they asked, "Well," you know, "do you think the Court will approve it? " Obviously he said, "We'll have to wait and see. We'll present it; we'll try and get it approved by the Court." Implicit in that is that if your Honor were to adhere to your original position that you wanted to make these public before the plea, we'd have to go back to the board. We certainly have no authorization -- we have authorization to go ahead and enter the plea if the Court approves it. We have no authorization to ever let this become public and the possiblility that the plea wouldn't be accepted. And I appreciate your position on that, and I think your Honor does understand the problem.

THE COURT: Well, is there anything else anybody wants to mention? I take it the government is joining in this request for sealing?

MR. MURRAY: Yes, your Honor. We previously had agreed to that, and we see no reason to change our position. We don't ever go back on our word, at least we try not to, so, yes, we'll join in that motion.

MR. CURNIN: We have, your Honor, at this point in time, fully executed papers on behalf of the Department of Justice, and the district, and on behalf of the defendant. We, in reviewing the papers last night, which came up in final form, found what we believe to be some typos and/or changes that should be made on about six pages. We do not believe that they are material, or in any way substantive.

However, Mr. Murray and Mr. Clark, although we just briefly disucssed it with them outside of your Chambers, have not had an opportunity to actually review those changes. We would therefore request that they be given time to review the changes, and discuss them with us, and to be sure that they are in total agreement, and therefore we would be in a position to see that these papers are filed with your Honor first thing tomorrow morning.

MR. MURRAY: Excuse me, your Honor.

THE COURT: Is there any way this could be transmitted to me tonight?

MR. MURRAY: I was going to ask the Court whether or not tomorrow morning was going to be too late, and whether or not the Court would want to see the documents that have been executed, and have amended copies, amended documents filed in the morning.

MR. CURNIN: The changes that we have, your Honor, are not substantive. I would join with the government in suggesting that the papers that we now have, fully executed papers by both sides, be made available to the Court at this point now, under seal. And that the very modest changes, which we think will be accepted by the government, can be reviewed with the Court.

THE COURT: I'd be content with only copies now.

MR. CURNIN: Very quickly.

THE COURT: So long as I'd have an opportunity to look at it as early as possible.

MR. MURRAY: Excuse me, I missed what the Court just said.

THE COURT: I said I'd be willing to look at copies. I don't need the original, so long as I get a start on the material, in the event I do have some questions.

MR. CLARK: That would be acceptable to the government, your Honor, with the understanding that the government has not yet had an opportunity to review each of the proposed changes that the defendant wishes to make.

THE COURT: I thought they were typographical. Am I correct?

MR. CURNIN: That is correct, your Honor, with one exception. But, I mean, the changes that we're proposing are such hat we can quickly review them with the Court at a later time. For the Court's benefit, we are willing to give to the Court the copy that we currently have without all of these changes, because they're not substantive. So that the Court will et the benefit of what we have agreed to in the current draft.

MR. CLARK: That's perfectly acceptable.

THE COURT: All right, that would be good. I'd like hat.

MR. MURRAY: Should we be available for you this evenig, your Honor, if you are so inclined to start reviewing thos documents?

THE COURT: No, no, I don't think so.

Why is Thursday so pivotal?

MR. BUNDLEY: Mr. Ogren's coming down Thursday, the Chief of the Fraud Section. That's one of the reasons. He's the highest career officer, as your Honor pointed out.

THE COURT: How much longer does this Grand Jury have to run?

MR. MURRAY: Not long, your Honor. It was our present intention to present this matter to the Grand Jury next week, presenting a full indictment to the Grand Jury next week.

MR. CURNIN: Your Honor, we have been, as we just discussed, most fortunate to date that there have been ~~no leaks.~~ And, you know, we're here in the courthouse, and if it meets the Court's schedule I think it would be to everybody's interest to do on it Thursday, if we can, before there are any leaks.

MR. MURRAY: Your Honor, one of the reasons that the matter is being presented now for Thursday, is that this is what I call the 11th hour, about a minute or so to go, because the government's in a position, in the event that this matter is not accepted by the Court, we are prepared, and have to move next week to present the matter to a Grand Jury.

And we think if there is going to be an arrangement, which has been executed, that the matter ought to be done so expeditiously.

THE COURT: And you're strongly recommending the agreement?

MR. MURRAY: I am strongly recommending the agreement, your Honor. I was a person, along with the Postal Inspection Service, and along with Mr. Clark, and the Justice Department, but our district initially started this action, and I've seen it through since April of 1982, I'm familiar with all the facts, familiar with all counsel, familiar with the company familiar with all the various crimes that are charged in the information, and with the full investigation, and I believe tha the agreement that's entered into today, by the company and by the government, is a fair one. A fair one to the United States, and I believe one that the court should accept.

THE COURT: Okay. Why don't you submit the copies to me?

MR. MURRAY: Your Honor, will I have to give you a Clerk's information sheet and all the other documents, or could I give that to you tomorrow morning?

THE COURT: Tomorrow.

MR. CLARK; Your Honor, I've just passed over to you the information, the United States versus E. F. Hutton and Company, Inc; a plea agreement between the United States and the E. F. Hutton Group, Inc; as well as E. F. Hutton and Company, Inc; a complaint for permanent injunction in a civil action, United States versus both Hutton Group and Hutton and Company; a consent and undertaking in that same action; as well as a proposed final judgment of permanent injunction against both entities in the civil proceeding.

THE COURT: I notice the orders indicate Harrisburg, Pennsylvania?

MR. MURRAY: Your Honor, we reviewed that and that has to be changed to Scranton. Originally we believed that this matter was going to be handled in Harrisburg, but basically because the lead violation occurs in Luzerne County, more appropriately it would be handled in this district, in this situs of the Court.

And we believe, also, that the Chief Judge should handle this matter, because it is very sensitive.

THE COURT: All right. Well, can everyone, or will everyone be made available for Thursday, at say 10:00 o'clock?

MR. MURRAY: Yes, your Honor.

MR. HUNDLEY: Yes, sir.

THE COURT: It may be in camera and it may not, but it probably will be. So if you can be in the vicinity of 10:00 o'clock on Thursday, does that pose a problem?

MR. CURNIN: No, it doesn't, your Honor. I was just thinking that maybe Mr. Ogren's coming up from Washington so he might appreciate the other half-hour, but --

MR. CLARK: No, he will be here tomorrow night, your Honor.

MR. CURNIN: Would we know prior to that time, your Honor, whether the Court is willing to accept the plea?

THE COURT: Well, that's what I'm saying. I may have some questions that I'd want to address in camera. And I may not. But if I don't, I'll just say, "We'll go right into open Court."

MR. MURRAY: Your Honor, we'll be available tomorrow.

THE COURT: I suppose my indication that I'm going into open Court, under the circumstances, would be properly construed that I'm accepting the recommendation.

MR. CURNIN: Should your Honor wish, although we're going back this evening, we will come back and be available tomorrow afternoon if you indicate to us at noontime that you have some questions that you want to put to us tomorrow.

THE COURT: Well, we might even be able to accomplish that by phone, do you think?

MR. CURNIN: Fine, we'd certainly appreciate that, your Honor.

MR. HUNDLEY: Sure.

THE COURT: Okay. Anything else, gentlemen? All right.

MR. CLARK: Is that 10:00 o'clock Thursday?

MR. HUNDLEY: 10:00 o'clock.

THE COURT: 10:00 o'clock.

MR. CURNIN: Thank you for your time, Judge.

THE COURT: I'll see you, gentlemen.

(Record is closed.)

* * * *

CERTIFICATE

I hereby certify that the proceedings are contained fully and accurately in the stenographic notes taken by me during the hearing of this matter, and that this copy is a true and correct transcript of my said notes.

Official Court Reporter

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA,

v.

E. F. HUTTON AND COMPANY, INC.,

Defendant.

CRIMINAL NO. 85-00083

BEFORE: HONORABLE WILLIAM J. NEALON,
Chief Judge,
United States District Court,
For the Middle District
of Pennsylvania,
Pre-Trial Conference,
at Scranton, Pennsylvania,
on, Wednesday, May 1, 1985.

APPEARANCES:

FOR THE GOVERNMENT: ALBERT MURRAY, ESQ.,
Assistant United States Attorney,
Scranton, Pennsylvania

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(In Chambers, 3:30 p.m., Wednesday, May 1, 1985.)

THE COURT: Gentlemen, I'm not looking for all the answers, I'm just trying to get some type of a grip on this, and I haven't gone through all of the papers yet.

Let me take some things in reverse. The plea agreement, Page six, which would be Subsection 4(f), "within sixty days ... the bank shall file with the Special Master, and with the Hutton Company, its claim for restitution."

Then the Hutton Company is to have a certain period to attempt to resolve the claim on its own?

MR. CURNIN: Yes, your Honor.

MR. MURRAY: I might indicate for the record, your Honor, who's present?

THE COURT: All right.

MR. MURRAY: We have Thomas F. Curnin for the defendants, and Thomas Kavaler for the defendants, and Thomas Vanaskie for the defendants.

THE COURT: And where are you from Mr. Curnin?

MR. CURNIN: From New York City, your Honor.

THE COURT: And Mr. Kavaler, New York?

MR. KAVALER: I'm his partner.

MR. MURRAY: And also Peter E. Clark, for the Department of Justice.

MR. CLARK: The intention, your Honor, of that provision was that the mechanism for resolution and settlement of the particular claim by a bank was hoped to be almost mechanical. And that there would, if there were no unusual problems, there would be no need to involve the Special Master for the initial period, if Hutton and the bank could reach agreement.

THE COURT: Is there any basis for anticipating that the banks, all of them, or most of them, will opt for a restitution claim through a Master, rather than seek a remedy on its own?

MR. CURNIN: I think, Your Honor, that it's so, because of the mechanism that has been established here. In that there's a clear-cut formula set forth; were going to be governed by their records; and they get full interest payments; and there's a very expedited procedure provided for here.

Therefore, we believe that most of the banks, indeed all of the banks who feel they have a claim, will recognize that this is an expedited procedure established so that those claims can be quickly resolved, and not left to much doubt because of the application of the agreed-upon formula. So we think they will come in, Your Honor.

THE COURT: What crossed my mind, I don't know what other jurisdictions would allow, but whether some would feel that separate action might open up a wider damage claim.

MR. CURNIN: Well, Your Honor, they're free to do that.

THE COURT: Yes, I understand they're free, but my question was, are you optimistic that most of them will not, or that all of them will not?

MR. CURNIN: Well, our choice, Your Honor, our preference would be that they take advantage of the restitution program. We're, I guess you could describe it, as being optimistic that they'll follow this route, because it provides a much cleaner, a much quicker remedy for them than what might prove to be a costly and time consuming route elsewhere, at which potential, I suppose, counterclaims and what not could come up in the course of that litigation. But here they have a pretty expedited route?

THE COURT: I suppose what I was thinking about was whether some jurisdictions would allow for any punitive damage claim the bank might want to pursue or seek to pursue.

MR. CURNIN: It's available to them, Your Honor, but we think that they'll recognize that this is a procedure which literally makes them whole.

THE COURT: And once the bank opts in, then it can't withdraw, under the agreement?

MR. CURNIN: Correct, Your Honor.

THE COURT: Except for this manifest irrationality or conflict. And that's Subsection L. It says, "The determination of any claim by the Special Master shall be final. However, in any instance in which it may appear to the Special

Master, to Hutton Company or to the claimant bank that the Special Master may have a conflict of interest, or that his/her application of the formula set forth in Exhibit C hereto was manifestly irrational, either Hutton Company or the bank shall have the right to apply to -- to apply within," there's a mistake there. I'm sure it means "to the Court within 30 days."

MR. CLARK: That is one of the corrections.

THE KAVALER: On Page nine there's a typo which Your Honor just discovered. I can hand up to the Court new ribbon copies of those pages.

THE COURT: No, that isn't what bothers me, or not that it bothers me. "For consideration of a particular claim." My question was, assuming that happens, does the Court merely decide whether there was a conflict, or the application of the formula was manifestly irrational, or does the Court decide the claim on the merits?

MR. CURNIN: No, I think not, Your Honor. I mean, it's the former.

THE COURT: It's the former. All right. And then if it is the former, if the Court found it to be manifestly irrational, it would be sent back to the Master to make a redetermination?

MR. CURNIN: Right. I think a redetermination in accordance with the formula, your Honor.

THE COURT: Yes. Now, what if there is a conflict?

MR. CURNIN: Well, in that situation we might be able to agree among ourselves. In other words, we and the bank, that in this particular case, whatever reason, the Special Master has a conflict, let's submit this to somebody else, or, indeed, waive it.

What we were thinking of is, that the Special Master, it might be that he or some member of his family might have an interest in a bank. And if it's one bank, I think my overall judgment would be, at this time, we'd have to weight the facts, would be to say, "We waive it."

THE COURT: Yes.

MR. CLARK: That provision, Your Honor, was inserted because of the chance that any Special Master, whose name might be agreed upon between the government and Hutton, might personally, or a member of his firm, might have represented one of the large number of banks that are involved here. And, frankly, that was a slightly greater concern of ours than the concern over whether a specific determination of a Special Master might be, in the opinion of one of the parties, irrational.

THE COURT: If it comes before the Court, what kind of record do you contemplate to present to the Court to determine if it is manifestly irrational?

MR. CURNIN: We would take the claim form that had been submitted, juxtapose it with the formula, and by running the numbers through the formula establish that the determination was not in accordance with the formula. We believe it would be a simple straight forward application, your Honor.

THE COURT: So you're saying that it's almost inconceivable to envision a situation where it would be manifestly irrational?

MR. CURNIN: We believe, Your Honor, that that may be the case.

MR. CLARK: That's the government's view, your Honor.

THE COURT: Okay. Well, I'd like to get back to the Information, and to see if you could, in some way, make it graphic for me. Use a hypothetical or an actual situation, because I must confess, initially, I'm having difficulty grasping it.

MR. MURRAY: I could do one or another situation. We have a Grand Jury Exhibit, which is a chart, which graphically depicts the cash concentration system that was in effect in 1980, '81 and '82, during the period. And we also have graphic depictions of the certain accounts that Hutton maintained at one of the banks in the Middle District of Pennsylvania.

THE COURT: Well, let's start, if you will, with Paragraph two of the information on the second page. The beginning of the second completed sentence, where it says, "In each of its domestic operating regions, the defendant company maintained branch offices supervised by branch office managers." Let's take the Middle District. What would you be talking about?

MR. MURRAY: For example, your Honor, in Wilkes-Barre, Pennsylvania, for example --

THE COURT: Is there one in Scranton?

MR. MURRAY: No, there is not. There is one in Wilkes-Barre, Pennsylvania, in the Middle District of Pennsylvania. There is one in Harrisburg, Pennsylvania, in Camp Hill. There is also one in Williamsport, Pennsylvania. Those are the three branch offices.

THE COURT: And what region would they come under?

MR. MURRAY: That would be in the Atlantic Region, your Honor, the headquarters in New York City.

THE COURT: In New York. All right. So the branch office here, in additon to a branch office manager, also employed a separate person, known as an operation's manager?

MR. MURRAY: The types of personnel, sometimes it varied in Hutton Branches, where the branch office manager was the head of the office, and basically the front and back office operations, sales and also the treasury function of the office.

There would also be --

THE COURT: When you say back office, what do you mean? As distinguished from what?

MR. MURRAY: The front office would be the sales.

THE COURT: All right.

MR. MURRAY: Monitoring the activities of the account executive. There would also be -- the back office would be the actual logistics or operational end of the branch. There were, in some branches, a branch operations manager that actually handled the mechanics and logistice of the branch office. Including supervising the method in which funds were received by the office and transferred to different locations.

Also in the branches, a branch office cashier, who directly handled the receipt of funds, and also the disbursement of funds to other locations. There was another personnel --

THE COURT: Would the branch operation manager be --

MR. MURRAY: The head of the office.

THE COURT: He would not be subordinate to the branch manager?

MR. MURRAY: The branch operations manager would be. The branch office manager would be the head of the actual local office.

THE COURT: Okay.

MR. MURRAY: He would have, as support staff, a branch operations manager.

THE COURT: And a cashier?

MR. MURRAY: And a cashier, and also, in some branches, a wire, a branch wire operator. A person who would be in charge of wiring information from the branch to either a regional service center within the particular region, or to New York. So there would be -- plus account executives. So there would be the approximately five categories of employees within a branch.

MR CLARK: At the same time, Your Honor, the branch operations manager would have another reporting function. He would take instructions from his counterpart in the regional office. So that whereas within the branch office the operations manager would be subject to the control of the branch office manager, he would also occasionaly, or for some aspects of his work, take instruction from an operations manager for his particular region. So it's, and I think the term used is, a dual reporting.

MR. MURRAY: Well, in the region -- that would be the branch level. At the regional level, one step above, the regions, which were for the purposes of servicing the branches, they were staffed, the region was staffed by a regional vice-president; a regional sales manager that would be in charge of all the sales or front office for the region, which would service the branches; a regional operations manager that would be the liaison between the regions and the various branches and branch office personnel; and also a regional cashier. That regional cashier would handle the function, or back office function between the regional cashier and the branch cashier. That would be the group of persons staffed in the region. They would overall supervise the operation of the multitude of branches within that particular region.

At the third level there would then be senior management, in New York at the headquarters, who they would report to.

THE COURT: The functioning of the operations manager, as distinguished from the cashier, would be what?

MR. MURRAY: The operations manager in the region --

THE COURT: The branch, I'm talking about.

MR. MURRAY: Okay, the branch. The operations manager was an intermediary, really, between the branch office manager, that would have the general supervisory function of all branch personnel, and the cashier. They would handle the administrative function of the branch, and coordinate that with the branch cashier and with regional personnel.

THE COURT: The branch manager in the branch would be a higher echelon than the cashier?

MR. MURRAY: Yes. If there is any clarification by the company of that structure?

THE COURT: All right. Then in Paragraph three, "Funds received from said customers were ordinarily first deposited in various local depository accounts," do you see where I'm at? It's the second full sentence.

Now, using Wilkes-Barre as an example, the office in Wilkes-Barre, where would they make their deposit?

MR. MURRAY: Those deposits would be, during the period of time covered in the information, would be made to the United Penn Bank in Wilkes-Barre, Pennsylvania, by the branch office cashier at the Wilkes-Barre office.

THE COURT: Is there any significance to "ordinarily first deposited?"

MR. MURRAY: On some occasions there were what we might call sub-regional accounts, and many times monies would be deposited in those regional accounts.

THE COURT: Does that have any significance as far as the information is concerned?

MR. MURRAY: Not of any major significance, your Honor.

THE COURT: Okay.

MR. MURRAY: Your Honor, also I might point out, I believe there's change on that page, Page 2, at the bottom. In Paragraph three, 600 banks we'll change to 400 banks, I believe, is that correct?

MR. CURNIN: Yes.

THE COURT: 400 was mentioned yesterday, I know.

MR. CURNIN: Yes, your Honor.

MR. MURRAY: Was it? I'm sorry.

THE COURT: It was mentioned orally, I thought by you. I made a note of 400. Or maybe it was by Mr. Curnin.

MR. CURNIN: You may have the corrected page already, Your Honor, in the Court's --

THE COURT: No, my notes indicated it, and it was you. That you said there were 400 banks involved, and that you agreed to be bound by the bank's records.

All right, Paragraph four on Page three, now. These accounts were opened, or were used "for the collection and concentration." Now is that a word of art, "concentration."

MR. MURRAY: Yes, it is, your Honor.

THE COURT: All right. What does it mean?

MR. MURRAY: The way the cash money management system works, is that all the various branch accounts within Hutton's domestic regions and branches, et cetera, would take in local funds, or funds received from customers, from all of these various 400 branches. The aggregate of all those funds would then, in the course of one region, would then be concentrated into one regional location. So that, for example --

THE COURT: Not the regional office?

MR. MURRAY: Yes, the regional bank account. Each region had a bank account and on some situations a sub-regional bank account. Each local depository -- excuse me, local branch or branch office had a local depository. So that customer funds would first go into the local depository, from all the various branches across the region, and then be transferred, in the aggregate, to a regional depository for their concentration.

So that if there was a $100.00 taken in of customer funds, or other funds within five various branch offices within the Atlantic region, each local depository would have in it $100.00 apiece. Via a check mechanism, which is called, later on, a depository transfer check, those funds are transferred into one account in the region. And that deposit then, in the regional account, would show $500.00.

THE COURT: And that would be done by a regional representative?

MR. MURRAY: Yes, it would. What would occur, is that the branch office cashier would, by telephone, notify the regional cashier of the amount of funds that were then being deposited in the branch account, and that regional cashier would then notify the regional depository, for the purposes of having a check, then called the DTC, used to then be deposited in the regional bank account.

So what would happen, you would have five separate DTCs, or checks going to the regional account, thusly aggregating to the aggregate amount of $500.00.

THE COURT: Getting back to your United Penn again.

MR. MURRAY: Yes.

THE COURT: When informed of that, would someone at the regional level issue a check drawn on the United Penn Bank?

MR. MURRAY: Yes, they would.

THE COURT: And deposit that --

MR. MURRAY: Into the the regional depository. And I believe it was at Rochester, New York, in the Atlantic Region. For some occesions, and I may be factually off on my facts a little bit, that would be deposited in the prime concentration bank, in Manufacturers Hanover Trust Company, in New York. So on some occasions it would go directly to New York. But on many occasions, and especially in the Atlantic Region, the regional concentration bank was located in Rochester, New York. I believe it was the Lincoln First Bank of Rochester.

THE COURT: And is that a necessary ingredient in the scheme?

MR. MURRAY: Yes, it is, Your Honor. That would be the second step in the concentration process.

The last and final step in the concentration process, where you have a regional concentration bank and a prime concentration bank, would be a transfer then of that $500.00 into the prime concentration bank, which is located in New York City. What would occur is that the various regions, who would have then concentrated all of the money from these various branches, in a funneling effect into the regions, would then concentrate that, once again, into the prime concentration bank.

So what would occur is that a bank in New York, Manufacturers Hanover Trust Company, and for five regions, Bank of America in California, would then draw checks on those regions, further concentrating and funneling the money into those two lead locations.

THE COURT: In the meantime the check drawn by the region on the United Penn Bank, it was not presented?

MR. MURRAY: The checks that are transferring the funds, are transfer checks. And what occurs generally, had to occur, is that the next day those checks will now then start to go down. And that's what's called the draw out system. And therefore will then transfer, actually transfer the funds from the local depository to the region, finally to be collected in the prime.

So on day one these transfer accounts would be going upwards in the transfer of funds. And the next day they would be going down.

THE COURT: But in day one, at the top level, would they have the use of that money?

MR. MURRAY: They would have the use of the money the next day. What occurs is that all the funds that are concentrated by depository transfer check, they are not what we call collected funds at the time they're deposited in the account. Nor will the prime banks make those funds, that are represented by the deposit, available on the first day of the transfer.

THE COURT: Okay.

MR. MURRAY: By policy of the prime concentration banks, and especially the one in New York, they would make available those funds the next day. That would be, for instance, in a seven-day week situation, five-day working day situation. They would make those funds available for use by the company on Tuesday, based upon a transfer in the account on --

THE COURT: On Monday?

MR. MURRAY: That's correct.

THE COURT: Well, they would have no use then, on the New York level, of those funds?

MR. MURRAY: Until Tuesday.

THE COURT: On Monday?

MR. MURRAY: On Monday, that's correct.

Now, as a part of this scheme we'll be alleging that on certain instances the company did try to obtain use of the funds, or did obtain use of the funds prior to their availability, by being made available to the company.

THE COURT: Did that involve any cooperation or collusion with the banks?

MR. MURRAY: The banks did not knowingly participate in the activity. The banks had arrangements with the company with the understanding that the funds to be transferred into the banks would be ligitimately received funds from customer transactions. And to the extent that the banks were under the impression that these funds were received from customers, would be the extent they would have allowed them to draw against these funds.

But, later on, what we charge in the information, is that funds in excess of customer funds were drawn down, or written on these accounts.

MR. CLARK: Your Honor, did I understand the Court to inquire as to whether the concentration system that Mr. Murray was describing was a necessary step --

THE COURT: Yes.

MR. CLARK: -- in the scheme? I believe Mr. Murray can explain it better than I can, but I believe the description he is giving of the draw down system, or the concentration system, is a description of a mechanism, which may or may not be illegal, depending upon the nature of the funds which are being drawn down through this system.

MR. MURRAY: But the normal method, and the evidence that we have and the investigation would show, is that cash can be concentrated in one or two ways. Generally via a check, which transfers and concentrates it, or via a wire transfer, which effects immediate transfer of funds. There are two --

THE COURT: Does the concentration of funds have any legitimate purpose?

MR. MURRAY: Yes, it does.

THE COURT: All right.

MR. MURRAY: There are two sides to, basically, cash money management involving corporations. One is the concentration of funds, the receipt as quickly as possible of customer funds.

And the other side of it would be the disbursement of funds for vendors or customers. So there are two types of system: The concentration system and a disbsursement system. The concentration system basically is for the purposes of just receiving and utilizing, as quickly as possible, the funds that are legitimately received during the course of the business of the company, which obviously, to a certain extent, is used to fund the payments that have to be made to vendors and other payees.

So what you have is a double system. One concentrating money that's received by the corporation, and the other side of the coin would be disbursing those funds to its creditors, to the company's creditors. And that's how the two are linked.

For the purposes of this Information and these charges, we're concerned with the scheme of unlawfully concentrating funds in excess of those funds that were legitimately received during the course of the Hutton's business purposes. That's what we are attempting to correct in this situation.

MR. CLARK: Drawings which were against uncollected funds, as opposed to drawings against collected funds in the banks.

MR. MURRAY: Maybe I should clarify what that is?

THE COURT: Yes, I was just going to say, distinguish that for me.

MR. MURRAY: If I can.

Funds that are collected, in banking terms, basically there are two types of -- defined in two ways. Funds that are collected are funds that have actually cleared the banking system.

Checks that are deposited in one location, drawn on a bank, go through the payments mechanism system and become checks in the process of collection. Two things happen to those checks. Either those checks are actually cleared through the banking system, and the payor bank actually pays that item, and those funds now become collected funds, funds that are available to be drawn against by the person depositing the check and taking the check out.

The second way is that a deposit of a check, an item, and through the Federal Reserve System the Federal Reserve allows the depositing bank or entity to receive credit provisionally on that deposit prior to its actual collection, and that is a provisional credit. Those funds, as far as a commercial corporation is concerned, often times banks will allow that commercial corporation to draw against those provisionally available funds.

Those funds therefore, from banking terms, are considered to be collected funds, or available funds, although the check is still in the process of being collected. In essence what happens is that the Federal Reserve System extends credit to the depositing entity. So those funds, if the bank allows the corporate entity to draw against it, are either available funds or good funds.

THE COURT: And they're legitimate?

MR. MURRAY: And legitimate funds, so long as the entity allows the corporation or business to draw against those funds. Then they become available funds.

THE COURT: When you say the entity, you mean the bank?

MR. MURRAY: The entity, meaning the corporation, meaning the person trying to seek availability of those funds, to draw against those funds.

For example, if I deposit a check in my bank account, say drawn in Wilkes-Barre, Pennsylvania, drawn on a bank in California, my bank can do one of two things. They can allow me availability of those funds, meaning that I can draw against that check, the amount of that check, when they receive availability provisionally from the Federal Reserve System.

Or what they can do is, say you cannot draw against those funds until I'm certain that the check that is in the process of collection has actually traveled through to the bank that's to pay that check. And those funds then become, the payment becomes final and therefore the collection period is over. Then I can draw against that.

THE COURT: Well, is each bank allowed a certain amount of provisional Federal Reserve approval?

MR. MURRAY: The Federal Reserve publishes what we call a federal availability schedule. From each point within the collection -- the payments mechanism system in the country, the Federal Reserve says, any checks that are deposited in these particular locations, we will give you credit, and make funds available based upon what we consider to be our anticipated collection time. So each bank will differ, but the Federal Reserve is consistent in allowing the availability of funds for certain in-point locations.

So what occurs is, it is optional with the bank as to whether or not it will allow a customer to draw against funds, when funds are available to it, meaning the bank, by the Federal Reserve, or whether or not it wants to hold the check and not grant availability to the customer, depending upon how long it takes the actual check to clear the banking service. So largely that is a bank policy.

In situations where you have large corporations and cash managers, we are trying to establish a procedure whereby there will be an agreement between the cash manager and the bank as to when funds will become available, and when funds will be allowed to be drawn upon by that corporation or entity.

THE COURT: All right. Well, were there instances here where the bank allowed Hutton to draw on accounts that had not been provisionally approved?

MR. MURRAY: There were situations, and what we believe and what we can prove that the fraudulent situation is, is that the banks did not knowingly allow Hutton to draw against these uncollected funds. Meaning funds that had not cleared the banking system, or funds that were presently in the process of collection; that it was Hutton's scheme to do that; and when Hutton does that through its techniques and procedures, what, in fact, it does, is drawing against the liquidity of the bank, and it is reducing, it is drawing against the assets of the bank. In essence, it is taking out a bank loan. Because the funds that are in the bank are purely a ledger balance fund. It's not collected.

THE COURT: Why wouldn't a bank be aware of that though?

MR. MURRAY: The bank is aware of the actual depositing of a check, and a withdrawal of a check. Many banks throughout the country, and there are 14,700 banks, are unaware of the float time, cannot compute the actual time it takes a check to clear. The banks did not knowingly allow this to occur, and did not know that Hutton had a policy, which was established by senior management, to intentionally and willfully overdraft its bank accounts, and then to extend the period of uncollecteds position by creating float, or extending the period in which the checks would be collected within the system.

MR. CLARK: And the reason, Your Honor, that the banks were unaware, is that Hutton, as part of the scheme, systematically deposited covering checks, which showed up on the banks ledger balances, and compensated for the withdrawals that were being made of uncollected funds.

Now, there are, as Mr. Murray will explain, permutations of the withdrawal procedures. Very simply put, whereby Hutton withdrew arbitrary amounts, amounts greater than customer funds being deposited. And, in turn, covered those excessive and arbitrary withdrawals with other Hutton checks. And, during this process, the banks that were affected, by looking only at their ledger balances, were unaware of the technique and the practices that were being used by Hutton in its banking transactions.

THE COURT: The top management officials who developed this scheme though, are not being indicted, are not being --

MR. MURRAY: That's correct, Your Honor. I might indicate that for the scheme to be implemented throughout the country, branch personnel, as well as regional personnel were involved in actually making the deposits and making the withdrawals.

We can state generally, for these purposes, that senior management provided an inducement for this activity to occur by granting credit, or interest, or monies to the various branch personnel to induce them to, in fact, overdraft these accounts.

What occurred was that certain regional personnel, branch personnel --

THE COURT: So on the branch level they would be aware, would they, that what they were doing was improper?

MR. MURRAY: In many branches, yes. In many branches branch office personnel were following orders; did not understand, in all honesty, the system.

THE COURT: Because it came from on high that it was permissible?

MR. MURRAY: A very technical area. Many of the branch office personnel and regional personnel were explained that part of this mechanism was for the purposes of recapturing float, or taking advantage of excess monies that were left in the account.

THE COURT: Would a branch manager receive any financial benefit from that?

MR. MURRAY: Yes, the branch office managers received financial benefits from overdrafting their account and of extending the float period, in order to get additional credits from book balances, of the negative book balances that would be in the account.

THE COURT: Are they paid on the basis of volume?

MR. MURRAY: They're basically paid on the basis of volume, plus have a very small imprest salary. What we have in many of these situations, your Honor, which we're charging, is the regions operated almost as separate corporations, with separate heads. And in many situations the regional service centers, and also the branches, modified -- they were given the authority and had the authority to modify the various draw-down procedures. In other words, procedures to transfer the funds from one location to another.

And they were encouraged to be aggressive in modifying these draw-down procedures in order to create additional funds for the firm, by reason of the overdrafting of these bank accounts, and they did so. Many times with the knowledge of senior management, as senior management -- in certain portions of senior management would monitor the accounts, and on a daily basis.

THE COURT: Why, as part of your agreement, would you not seek some individual pleas?

MR. MURRAY: Well, we believe that because of the permutations on the system, because it was so widespread, in other words, in order to -- it's a complicated area. Because of the widespread nature of the activity, because of the benefit to the corporation as a whole, and because of some of the novel --

THE COURT: Are you saying it's a prosecutorial decision to come out with the best arrangement that you think you can?

MR. MURRAY: Well, we think this arrangement, and agreement that we have is in the best interest of the United States. We think in certain instances it may be unfair to charge possibly thousands of persons who might be -- who might have done some things under instructions from on high, but then we have little operating entities within the course of Hutton's structure. And on some situations, in many situations while following corporate policy there were deviations from the normal draw-down procedures, but within the same framework of the corporation's inducement to create these credits.

THE COURT: But is there any one, or small group on top orchestrating the scheme?

MR. MURRAY: Well, there was a general policy running throughout the corporation, Your Honor, and as I guess the Court would realize, that any large corporation such as Hutton has different segments and departments. And we might say that the treasury part of the business, or the money management and operation departments had general knowledge of the activity, and knew that the activity was going on.

THE COURT: Was it something inherited?

MR. MURRAY: It was as a result of, at least the time period charged in the information, it was a result of the interest rates that greatly increased during the period of time between 1979, 1980, '81 and '82. And we believe that because of the interest on loans, and because of the interest rates, the company decided to increase their capital, their working capital in order to pay down their various bank loans in order to save on interest, expense, and also to generate interest income.

MR CLARK: This, Your Honor, was perhaps more a series of practices that developed and evolved, rather than were inherited. The practices changed during the years. The incentives, as Mr. Murray was referring just a moment ago, the incentives in the late 1970s, and 1980 and 1981, perhaps, where interest rates reached such a high rate, of 20, 21 and 22 percent, that not only brokerage firms, but corporations of all kinds, have found that the avoidance of paying such high interest rates was a matter of great priority. And by these practices of overdrafting the various depository bank accounts, they were able to obtain interest free loans, in effect, of significant sums of money, and thereby avoided borrowing those sums in order to provide the day-to-day capital, or part of the day-to-day capital that was needed by the firm.

MR. MURRAY: Your Honor, to further explain an individual situation. Of course, and I think I would be dishonest to tell the Court that there wasn't a division or a portion of the company that handled the money management. And of course, there was. But because of the distribution of various functions of money management throughout the corporation, and the independence, to a large extent, of the various regions and branches, where many regional personnel and the branch personnel could follow corporate policy while acting on their own, we felt that it was truly a corporate policy and --

THE COURT: Were there any regions or branches that did not operate in this way?

MR. MURRAY: Different regions, during different periods of time, times during the course of the scheme charged in the information, and, of course, our investigation extended beyond that, extended over a large period of time, operated in different manners.

For example, there was a draw-down sheet, which was a method in which a branch cashier, as well as a regional cashier could calculate the amount of funds that would be drawn out of the bank on a daily basis. It represented a portion of the company's overdrafting policies. And a portion of the monies that would remain in the bank, allegedly would remain in the bank, would be added to the daily deposits.

Now, our evidence will show, and maybe to some dispute by the company on some of these facts, that this draw-down sheet during various periods of time was used by certain regions, was not used by other regions, was used by certain branches and not other branches within the same region. And, while it was a company generated document, it was up to many regional heads as to whether they would use it within a region and therefore encourage their branches to use it.

THE COURT: What do you mean, a company generated document?

MR. MURRAY: It was a document that was generated by a Hutton employee to aid the branches and the regions drawing down various funds.

THE COURT: Spelled it out how it could be down?

MR. MURRAY: Spelled it out how it was done. This is -- used various multiples, and what I've referred to many times as algorithms or mathematical formulas designed to work out a specific result. Where it, on many occasions, created large overdrafts during weekend periods of times --

THE COURT: Weekend?

MR. MURRAY: During weekend periods. And also in order to gain the interest off of that. It also had within it a formula to recapture any excess monies left in the bank after the weekend period of time.

Now, this particular sheet, for instance, was, while generated by certain portions of senior management, many regions were able to and allowed to change that sheet, and modify it, depending upon the idiosyncracies of the regional bank or local bank. So that could possibly, to answer your question --

MR. CLARK: I think what we really have to do, what the government has to do in this proceeding, your Honor, is to avoid making any statements as to the culpability of particular individuals. The disposition, as set forth in the plea agreement that's been negotiated between the parties, by that plea agreement the government has agreed not to prosecute any individuals. The basis for that is that it's the government's conclusion that the overall disposition is a fair one and meets the interests of the United States.

But I don't think that we can go into, or should go into consideration of culpability of particular --

THE COURT: No, that's more on the track in which I was headed. You feel that was a concession that the government --

MR. CLARK: It is a concession in which, under the facts and circumstances of this case, the government, considering many factors, including the novelty of the application of the law to these facts, was an agreement that the government could make in the best interests of the United States.

MR. MURRAY: It was our decision, judge.

THE COURT: I'm sorry?

MR. MURRAY: I think it was our decision not to charge individuals.

THE COURT: Our, as distinguished --

MR. MURRAY: The government's.

THE COURT: Do you mean by that that it was a separate independent decision, or it was a part and parcel of the plea agreement of --

MR. MURRAY: It was part and parcel.

THE COURT: -- of a concession in the plea agreement in return for a plea by the corporation?

MR. MURRAY: Yes.

MR. CLARK: Taking into consideration the full range of relief that the government is able, should this plea be accepted, the full range of relief that the government, the United States will receive, including the relief that's contained in the injunctive provisions, and in the consent and undertaking, and the other provisions of the plea agreement, including the restitution provisions.

THE COURT: Let me ask, on Page three again, Paragraph six.

MR. MURRAY: Of the information, your Honor?

THE COURT: Yes. Under "(a) branch office cashiers of the defendant Hutton Company were instructed to calculate, on a daily basis, the net activity in their branch office's depository bank accounts. " I take it that would mean the local depository bank, would it?

MR. MURRAY: Branch Office's? That's correct, your Honor.

THE COURT: "And to transmit that information to their regional office cashiers."

MR. MURRAY: That's correct, your Honor.

THE COURT: "The regional offices maintained checks for each of the branch office depository accounts located in their regions, and the defendant Hutton Company's regional office personnel would thereafter prepare 'depository transfer checks', or 'DCT's" --

MR. MURRAY: "DTC's", your Honor.

THE COURT: Did I say "DCT's?"

MR. MURRAY: Yes.

THE COURT: I'm sorry. "'DTC's', drawn upon each branch office depository account, and deposit these DTC's into the appropriate regional office depository bank accounts."

MR. MURRAY: Excuse me, your Honor. I might add that on many occasions, though it's not reflected here, they have what they call and electronic DTC, and many times the bank generates the DTC, as opposed to the regional personnel, but that is not material to this.

THE COURT: "(b) following the process described in sub-paragraph '6(a)' above, the regional offices of the defendant Hutton Company would telephone the defendant's 'Cash Desk' in New York City." Now, would that be all of the regional offices throughout the country?

MR. MURRAY: During the period of time, some of the regional offices, and I believe during specifically this period of time five of the regional offices telephoned the activity to Bank of America in California, and I believe it says in here later, and the other regional offices went to New York. So, yes, all regional offices would go to one or the other.

THE COURT: And this would be on a daily basis?

MR. MURRAY: Yes, your honor.

THE COURT: "And report the aggregate net activity in the various regional depository bank accounts (which net activity included, as its primary component, the DTC's described above). Promptly thereafter, the Cash Desk would prepare DTC's drawn upon the regional depository bank accounts of the defendant Hutton Company's South Central, Southeast, Northeast and Atlantic regions and manually deposit those items into an account maintained at Manufacturers Hanover Trust Company, the defendant's prime concentration bank in New York City." That would be just from those four particular regions?

MR. MURRAY: That's correct, your Honor.

THE COURT: And that was done --

MR. MURRAY: On a daily basis.

THE COURT: Daily. And it was done manually, manually deposited?

MR. MURRAY: In some situations there would also be an electronic deposit, but that's not material.

THE COURT: Okay. "Information," and the reason I'm emphasizing information, is that there was a different procedure done, was there, for the western portion of the country? It says, "Information as to the amount of funds deposited into the defendant Hutton Company's regional depository bank accounts for its Pacific North, Pacific South, Mountain, Central and Midwest regions was telexed by the Cash Desk in New York City to Bank of America, the defendant's prime concentration bank in Los Angeles, California."

MR. CLARK: The distinction, your Honor, is, or the difference is that the funds that were being drawn down through western regions, or the regions in the western half of the United States, were going to be concentrated in another Hutton prime concentration bank in California, the Bank of America in Los Angeles. And the cash desk personnel, the Hutton cash desk personnel in New York City could not manually walk across the street, or walk across the street and manually deposit checks drawn on those regional depository banks. They had to communicate to the Bank of America, and arrange for the funds to be drawn down from the western regional depository accounts into the Bank Of America account at Los Angeles.

THE COURT: There was not a cash desk in Los Angeles then, is that it?

MR. CLARK: No.

MR. MURRAY: No, your Honor.

THE COURT: All right. "Bank of America, acting as agent for the defendant Hutton Company, immediately prepared DTC's drawn upon the aforesaid regional depository accounts for collection into the defendant's concentration account."

MR. MURRAY: There again you have a concentration of all the funds from the region into a prime.

THE COURT: And which concentration account?

MR. MURRAY: That was the concentration account of the Bank of America.

THE COURT: In the Bank of America. Okay.

MR. MURRAY: I might add that the Bank of America was also used as the prime disbursing bank for all vendor payment and all customer payments.

THE COURT: "(c) at various times material herein, the defendant Hutton Company maintained 'zero balance' accounts at United States Trust Company of New York and Chemical Bank in New York City and Bank of America in Los Angeles." Now, what is that?

MR. MURRAY: Zero balance account?

THE COURT: Yes.

MR. MURRAY: A zero balance account is a demand deposit account or a checking account that's used in cash money management circles as a mechanism to, what is called controlled disbursement. What occurs is that these are accounts that merely an imprest or a small balance remains in the account. And that checks are then allowed to be written on this account without having funds then and there in the account.

THE COURT: So the zero balance isn't literally zero, it's --

MR. MURRAY: It's a small imprest balance, very small.

THE COURT: But there is an amount drawn much in excess of the --

MR. MURRAY: That is correct, your Honor, and those are standard, those are accounts that are standard throughout the country.

THE COURT: You mean --

MR. MURRAY: Zero balance accounts are accounts that many major corporations use in their businesses.

THE COURT: Okay. So that --

MR. MURRAY: To have a zero balance account is, in and of itself, not unlawful.

THE COURT: Okay. "By arrangement with these banks, the defendant Hutton Company was permitted to draw checks upon these accounts -- in which the defendant Hutton Company was required to keep no balance -- with the understanding that the defendant would, on a daily basis, wire transfer into these accounts sufficient funds to cover all checks presented against the accounts for payment." Is there anything wrong with that?

MR. MURRAY: No, your Honor. I might also add, if the defense, Mr. Currin or Mr. Kavaler or Mr. Vaneskie have any corrections to what I'm saying, feel free to speak up.

MR. CURNIN: Your Honor, I don't feel that it's the position of the defendant to offer corrections as to the government's position as to what it would prove should there be a trial of this matter. And we rely upon the information as the charging document, and it's to that document and those offenses to which the company pleads.

MR. MURRAY: But for the purposes, as I understand, clarification of the charging document.

THE COURT: I was going to say, I would hope that if you detect me going off in the wrong direction in my interpretation of, or in my expression of interpretation in what Mr. Murray or Mr. Clark are advising me --

THE CURNIN: I'm separating out here, your Honor, that information which is descriptive of the operation of the cash concentration system, from the government attorneys statements as to who was responsible --

THE COURT: Yes.

MR. CURNIN: -- scope of culpability and the like.

THE COURT: All right, I'll accept that, but if there is anything in the former that you think requires, or is being misunderstood, either especially by me, but in explanation by the government --

MR. CURNIN: We will, your Honor.

THE COURT: You would do that, wouldn't you? All right.

Nine (b), Mr. Murray, on Page six. "Causing funds to be successively transferred between various branch and regional depository bank accounts of the defendant Hutton Company, prior to their deposit in a prime depository bank."

MR. MURRAY: Yes, your Honor.

THE COURT: Would they be Manufacturers Hanover and Bank of America, are those the two that you're talking about?

MR. MURRAY: Yes, those are the two prime depository banks. And what this paragraph generally refers to, is a situation whereby funds that would normally be drawn down from a branch, to a region, to a prime concentration bank, is diverted through the domestic system, and it is transferred through additional deposit locations in order to increase the amount of money, checks and dollars that are in this system, in the check clearing system, in order to create additional float on those funds.

And that is also used in conjunction with certain formulas that are designed to calculate the amount of funds drawn down. What occurs is that it creates excessive funds that bear no relationship to customer monies. That is --

THE COURT: Give me that again. Would you give me that again?

MR. MURRAY: What occurs is that when these multiple deposit locations are being used for the transfer of funds, it creates more funds within the system. And when that is then added to a multiple to also increase the amount of funds for a weekend period of time, it creates excessive funds over and above those which would normally have been created by virtue of the normal draw-down system from a branch. One branch to a regional location, to a prime location, or a branch location directly into the prime location.

What this provision relates to is a situation where you will have interbranch transfers, or interregional transfers. Meaning that multiple branches are used to have funds deposited into one another for the purposes of extending the clearing times of those transfer checks between the branches.

MR. CLARK: These were what one might call lateral transfers from branch depository bank, to branch depository bank, to branch depository bank. Rather than in the normal sequence of branch depository bank into a regional bank, and into the prime concentration bank.

And if, your Honor, the Hutton personnel were applying a formula or other calculation when each successive drawn down was being arranged, if they used a formula whereby they withdrew an arbitrary or an excessive amount, then the fact or the juxtaposition of the lateral draw down is one in sequence, one after the other, each one applying a formula with a multiplier, or having a multiplier effect.

The aggregate draw down, when the chain or the lateral transfers were finished, the draw down into the regional account was far greater than would have been the aggregate of the amounts drawn down from each of the branch depository accounts.

THE COURT: Checks drawn on the zero balance accounts?

MR. MURRAY: Yes, your Honor.

THE COURT: What period of time would be covered before they'd have to be honored, be paid?

MR. MURRAY: Your Honor, that will depend upon the deposit location. And the clearing time that it takes for the zero balance accounts to go through the payments mechanism and be paid by the payor bank, or that would be the bank that the check was drawn on, generally that period of time can be one day, two days, or three days, or longer.

THE COURT: Or longer?

MR. MURRAY: Or longer. It will be longer if, and that's referred to basically as a bank float, the period of time that it actually takes a check to clear the payments mechanism. As opposed to the period of time in which the check will become provisionally available by the Federal Reserve. So what you may have is, that if a zero balance account is deposited in Wilkes-Barre, Pennsylvania, it may take four to five or six or seven days for it to clear.

THE COURT: You mean drawn on, say, United States Trust?

MR. MURRAY: Say, for instance.

THE COURT: Okay.

MR. MURRAY: However, once it's put into the Federal Reserve System, the Federal Reserve will honor that check and allow the bank to credit for that item, say, in one day, or two days.

THE COURT: Which bank now, United United Penn Bank?

MR. MURRAY: That's within the Third Federal Reserve District. And it would be traveling from the Third Federal Reserve District to the Second Federal Reserve District. It would be through what they call the ITS system, or the Interterritorial Transportation System through the Federal Reserve.

What would happen when that check, that zero balance check would hit, the account -- hit meaning it would be posted to the account for debiting against the account, at that point in time, during the afternoon, the bank would then call Hutton, or the corporation, and indicate that there are certain afternoon clearings, and therefore there has now to be money in the account to cover the clearing item.

And Hutton would then transfer money from its main prime account, which could be used as a concentration accoun, and then transfer money, wire transfer money to that zero balance account to cover the check clearing. So for a very fractional period of time there might be a book overdraft on the bank. And that's what would occur with those accounts, with a zero balance account.

THE COURT: But you say that's not unusual?

MR. MURRAY: That's not unusual. In this particular scheme, what we're charging, is that the zero bal nce accounts were not used for the purposes, the stated purposes that the company had indicated to the banks. And that was, t would be used for payments to vendors, third party vendors, payments for customer -- customer funds, customer checks and customer payments. And also for clerical errors or mistakes that would be made by any branch cashiers or regional cashie s.

Instead, these zero balance accounts, checks, w e being used to cover overdrafts that were created as a result of the initial draw down of excess money.

For example, we'll have situations where Hutton personnel, based upon a small amount of customer money, say $10,000.00, and these figures are not totally accurate, but obviously have accurate figures. Based upon the receipt of $10,000.00, would, on a single day, draw out, for example, $5,000,000.00, through the drawn-down mechanism. They would concentrate those $5,000,000.00.

Between the period of time it would take for the check, the second day, to come down and clear, the zero balance account would be used to cover that draw down, or the excess funds that were created as a result of the initial drawing down of the money. That was not a stated purpose for the use of that account. And, therefore, when that zero balance check was deposited, at the same time that the draw-down check from the main bank was pulling funds out, the bank in which the check, the original draw-down check was drawn, would have to collect from the zero balance account bank. And that would take -- there would be float period, a period of time of delay.

And during the period of time in which the zero balance account would be collected by the lower bank, the local branch depository bank, that would be the period of time of uncollected position. So the bank would be out the use of the difference between the actual collected customer funds in that account and the excessive overdraft. So we were basically referring to the misuse, the fraudulent use of the zero balance account to inflate bank balances to cover overdrafts, your Honor.

MR. CLARK: The excessive overdrafting of the branch depository banks, and the continuation on a daily basis of that amount of overdraft in a branch depository bank, would not have been possible had not BRC checks been deposited to cover each days successive overdraft.

MR. MURRAY: BRC checks refer to a term of art by the company. The company called these zero balance account checks. The checks drawn on the Bank Of America, the United States Trust Company and Chemical Bank in New York, they were called branch reimbursement checks.

MR. CLARK: I'm sorry, your Honor, I thought Mr. Murray had explained BRC.

MR. MURRAY: No, I hadn't. And they were used for the purposes of reimbursing the overdraft that was created initially in these accounts.

THE COURT: The other thing I wanted to mention. Upon reading this I had asked yesterday, who was prepared to enter the plea. And a name was given to me, but it's not one of those who's executed the plea agreement.

MR. KAVALER: It's a individual named in the resolution of the board of directors, your Honor. Specifically as one of the two individuals authorized by the board to plead on behalf of the company.

The board resolution authorizing the execution of the plea agreement and the entry of the corporate plea for E. F. Hutton and Company, Incorporated, says, "The plea may be entered on behalf of the company by either Mr. Scott Pierce, the President, Mr. Robert Witt, the Executive Vice President, or any other duly appointed Executive Vice-President of the company."

THE COURT: Where is this now?

MR. KAVALER: This, your Honor is in the --

MR. CURNIN: In the resolutions, your Honor.

MR. KAVALER: The board resolution.

THE COURT: Oh, in the board resolution. I thought you said in the plea agreement.

MR. KAVALER: It's attached. The plea agreement is silent as to who will speak for the company at the plea. The board resolution, however, which is attached to the plea agreement as the official minutes of the board, by which the board adopts the plea agreement, reads as follows: "RESOLVED FURTHER, that Scott Pierce, President of this Corporation, Robert E. Witt, Executive Vice President, or any other senior officer, be, and they hereby are, authorized to execute such Plea Agreement and enter a plea of guilty to an Information on behalf of this Corporation substantially in such forms as reviewed by this Board of Directors at this meeting."

Below that appears the certification of the secretary of the corporation. The corporation, again, your Honor, is E. F. Hutton and Company, Incorporated, and that secretary certifies that this is a resolution duly adopted at a board meeting on Tuesday, April 30.

So a corporate act has been taken, which duly authorizes either Mr. Pierce or Mr. Witt to execute the documents, and either Mr. Pierce or Mr. Witt to appear and plead for the company.

MR. CLARK: Or any other senior officer.

MR. KAVALER: Or any other senior officer.

It then transpired that Mr. Pierce executed these documents, and they indeed had been prepared for his execution signature on behalf of the company.

However, it is the company's proposal to have Mr. Witt appear tomorrow here in Scranton to plead on behalf of the company, this having to do with the relative schedules of Messrs Pierce and Witt.

THE COURT: And he will execute the plea agreement?

MR. KAVALER: No, your Honor, the proposal is, the plea agreement is executed. I think you don't have executed copies there: The government has, we have, and I think Mr. Clark has to hand up to the Court the original ribbon copy of the plea agreement bearing the ink signatures of each of the people who is indicated to be a signatory.

And the actual plea agreement that Mr. Clark has to hand up to the Court, bears an ink signature of Stephen Trott, the Assistant Attorney General, an ink signature of Robert Ogren, the Chief of the Frauds Section of the Department of Justice --

MR. CLARK: I believe, and excuse me, the Court's question really was, who would execute it on behalf of the defendants in the criminal case, and that's Mr. Pierce.

MR. KAVALER: It bears all of the signatures called for. However, the resolution authorizes either one of these individuals to execute the agreement and enter the plea. I don't believe it calls for the same individual.

THE COURT: I'm wondering, the colloquy would be asking Mr. Witt, whether Mr. Pierce and Mr. Lynch understood the --

MR. KAVALER: I belive, your Honor, the Board of Directors was adequately informed. Mr. Witt is also a director and was present at the board meeting.

(Mr. Hundley previously joined the conference.)

MR. HUNDLEY: As were Mr. Curnin and myself.

MR. MURRAY: Your Honor, we would not want to embarrass or cause any unnecessary inconvenience to anyone, but we would, the government would prefer to have a signatory to the contract -- to the agreement. I always say contract, excuse me. To the agreement, be present at the proceedings.

THE COURT: Can't that be done? That would be Mr. Pierce.

MR. CURNIN: I don't know whether it can be done or not, Your Honor. We had the document signed by the individuals that the government wanted to have appear on those documents, and we told them that we would have a resolution of the board identifying a very senior officer of the company to be here to take the plea, which we have done.

As Mr. Hundley has said, we were at the board meeting where all of this was reviewed. Mr. Witt was there, and we were there when this resolution was passed authorizing him to take the plea on behalf of the corporation. I can assure your Honor he is a very senior officer of the company.

MR. CLARK: For the record, your Honor, nothing has ever been said, prior to the government's receipt of this signed resolution, nothing was ever said to the government about Mr. Witt's presence.

MR. HUNDLEY: No, but with all due respect, and I know that Mr. Clark was present, there was a meeting with Mr. Ogren in Washington in the course of long negotiations. And there was some talk about who should come to put the plea in for the corporation. And Mr. Ogren made it very clear that he didn't want to designate who it should be, but it should be a senior officer of the company, a responsible senior officer who could appreciate the significance of the process, et cetera, et cetera. I believe that was my understanding. At least that's my recollection. I was at the meeting.

MR. CLARK: The government would observe, your Honor, that Mr. Witt's responsibility seems to be in the sales side of the defendants operations, and there is no allegation in any of the papers the government intends to file that any of the practices complained of, or charged in the information, or complained and alleged in the complaint, had anything to do with the sales activities of the defendant or its parent corporation.

So, Mr. Witt, in those circumstances, appears to be a person who may be aware of the action taken by the board of directors, but his responsibility within the organization seems to be in an opposite area.

MR. HUNDLEY: Everybody on the the cash management side has been before the Grand Jury, your Honor. We think that might be --

THE COURT: Is your recollection different from Mr. Hundley's then, as to Mr. Ogren's --

MR. CLARK: My recollection is there was no agreement as to who should appear on behalf of the corporation.

MR. HUNDLEY: I didn't say that. All I said is that Mr. Ogren said, that "I want it to be a senior responsible official of the company. We'll leave it up to the Hutton people to pick the officer." As long as he was senior and he was responsible. He didn't want us coming down here with the attorney for the company. You know, things like that, your Honor.

MR. KAVALER: I would I just note, your Honor, that everything that Mr. Clark said about Mr. Witt is precisely and identically true abut Mr. Pierce. He, too, comes out of the sales side. Indeed, he had Mr. Witt's title before Mr. Witt. That is, Mr. Pierce is the immediate past sales manager, national sales manager. He is now the the president.

As Mr. Clark well knows, the president is in charge of sales. The sales manager reports to the president. The president is not in charge of back office operations. That is not a function that reports to the president.

THE COURT: But shouldn't something of this size be entered by the president?

MR. MURRAY: That's my position, your Honor, our position.

MR. CURNIN: Your Honor, I don't believe that that's necessary. Mr. Hundley is correct that Mr. Ogren, from the department, left it to the company as to who would take the plea, provided it was a senior executive officer of the corporation. Mr. Hundley and I can represent to you that that is an accurate description of Mr. Witt. He is knowledgeable and he was authorized by the board to take the plea.

THE COURT: Excuse me.

(The conference was briefly interrupted by a telephone call.)

THE COURT: The call had nothing to do with our immediate discussion?

MR. MURRAY: No.

MR. CLARK: One call, your Honor, has an impact and perhaps we could adjourn. And then as soon as we resolve the matter that's before us, we might just take half a minute to discuss it with counsel, and then come back.

THE COURT: Well, I'd like you to discuss who's going to enter the plea, too. My personal feeling is that it should be the president, notwithstanding the resolution. If you want to discuss that --

MR. CLARK: As far as the government is concerned, your Honor, there was no understanding that Mr. Pierce, the President, would not be the corporate representative to come in and be present at the time the plea was taken. And if the Court believes that Mr. Pierce should be present, the government supports that. As president, the government believes he is the proper person to be present.

THE COURT: Yes, I think he is. He signed the plea agreement. That would be my position, that he should be here.

MR. MURRAY: Judge, would you --

MR. CURNIN: Your Honor, could we then have a five or a ten minute recess so that we can follow up on this particular subject and then report back to the Court --

THE COURT: Sure.

MR. CURNIN: -- in ten minutes or so, your Honor?

(5:06 p.m., Court recessed.)

(5:25 p.m., Court resumed in Chambers.)

THE COURT: Well, is there anything further you want to mention?

MR. CURNIN: Your Honor, Mr. Scott Pierce will be here in the courtroom tomorrow morning to take the plea on behalf of the company.

THE COURT: All right. Are you gentlemen staying overnight?

MR. HUNDLEY: Yes, sir. Or I am.

MR. CURNIN: Yes, your honor.

THE COURT: All right.

MR. CLARK: Yes, we are.

THE COURT: Can you be available, say around 9:00? Not for that, but I'm going to spend some more time on this. And what time can he be here?

MR. CURNIN: He can be here at 9:00 o'clock, your Honor.

MR. MURRAY: You mean tonight, right?

THE COURT: No, tomorrow morning. And in case I want to talk to you again. I may not, but I'll certainly let you know by 10:00 o'clock.

MR. CURNIN: Your Honor, when would you anticipate our being in Court for the purpose of taking the plea?

THE COURT: 10:00 o'clock.

MR. HUNDLEY: 10:00 o'clock.

THE COURT: Do you have a preferred time?

MR. CURNIN: Well, we would prefer it earlier, your Honor, for purposes of what impact this may or may not have, and we think there may well be impact on the trading in Hutton stock tomorrow. And if we could conclude the matter early in the morning, maybe before the market opens, I don't know if that's possible, then that would give us some flexibility --

THE COURT: What time does the market open?

MR. CLARK: 10:00.

MR. CURNIN: 10:00 o'clock.

THE COURT: Oh, 10'00 o'clock. Well, I'll be here early. I'd have no problem with 10:00, I don't believe. So can you make yourselves available at 8:30 then?

MR. HUNDLEY: Absolutely.

MR. CURNIN: Oh, absolutely.

MR. HUNDLEY: Earlier than that if you want.

MR. CURNIN: We'll be in Tom's office, your Honor, at 8:30, waiting your Honor's call.

MR. HUNDLEY: We'll be there at 8:00.

MR. CURNIN: We'll be there at 8:00 o'clock and just await a call.

THE COURT: All right.

MR. HUNDLEY: Sure, sure.

MR. MURRAY: You want us here at 8:00 o'clock, your Honor?

THE COURT: Maybe available. I usually get in about 8:00 or 8:15.

MR. CURNIN: We'll be available from 8:00 o'clock on.

THE COURT: All right, anything else then,

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gentlemen?

MR. CLARK: Would your Honor prefer that we file the papers with the Court at this time or at 9:00 tomorrow?

THE COURT: You mean of the originals?

MR. CLARK: Yes. We have the original and two copies.

THE COURT: When you say file, you mean file with me?

MR. CLARK: File with you.

THE COURT: All right, why don't you give me the original, because I marked these up pretty good.

MR. MURRAY: The only thing that has to go with that, and our procedure in the Middle District is to file two things. And that would be Clerk's information sheet, criminal, and also the Clerk's information sheet, civil. And I've prepared those, but I wouldn't be filing them at this time.

MR. CLARK: And filing of the waiver of indictment?

MR. MURRAY: Well, we filed the waiver of the indictment at the time of the colloquy, the making of the Rule 11. So, I could do that whenever the court indicated that these papers were now not under seal and I would file the Clerk's information sheet.

THE COURT: What changes are there?

MR. KAVALER: Typographical.

MR. CURNIN: Typographical.

MR. KAVALER: The one your Honor picked up before, "within" is in the wrong place in the sentence, things of that nature.

MR. MURRAY: Why don't we do it in the morning and if the Court indicates it will accept the agreement then we'll file it right then.

MR. CURNIN: We would prefer that procedure, your Honor.

THE COURT: That's fine with me.

MR. CURNIN: And we'll be available in the morning to make whatever changes have to be made, but they are strictly corrections of a typographical nature.

MR. CLARK: The Court does not require the plea agreement to be filed prior to the time the Court indicates whether the plea will be accepted, your Honor?

THE COURT: I'm sorry?

MR. CLARK: Won't the Court require that the plea agreement and the information be filed prior to the time --

THE COURT: Yes.

MR. MURRAY: Yes, I think that's right. I'm wrong.

MR. KAVALER: Depending upon whether the Court is going to accept that.

THE COURT: I'll let you know.

MR. VANASKIE: Judge, just one other minor housekeeping matter, and that would be the admission of counsel for Hutton Pro hac vice. I know you can do that on oral application, if you want to take care of that now or take care of it in the morning.

THE COURT: Why don't we do it in the morning. Okay, thank you, gentlemen.

MR. HUNDLEY: Thank you, judge.

MR. CURNIN: Good night, judge.

THE COURT: Good night.

* * * * *

CERTIFICATE

I hereby certify that the proceedings are contained fully and accurately in the stenographic notes taken by me during the hearing of this matter, and that this copy is a true and correct transcript of my said notes.

Official Court Reporter

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

- - - - - - - - - - - - - - - - - - -x
:
UNITED STATES OF AMERICA, :
:
v. : CRIMINAL NO. 85-00083
:
E. F. HUTTON AND COMPANY, INC., :
:
Defendant. :
- - - - - - - - - - - - - - - - - - -x

BEFORE: HONORABLE WILLIAM J. NEALON,
Chief Judge,
United States District Court,
For the Middle District
of Pennsylvania,
Pre-Trial Conference,
at Scranton, Pennsylvania,
on, Thursday, May 2, 1985.

APPEARANCES:

FOR THE GOVERNMENT: ALBERT MURRAY, ESQ.,
Assistant United States Attorney,
Scranton, Pennsylvania

ROBERT OGREN, ESQ., &
PETER B. CLARK, ESQ.,
United States Department of Justice,
Criminal Division,
315 9th Street, N.W.
Washington, D.C.

FOR THE DEFENDANT: CAHILL GORDON & REINDEL
BY: THOMAS F. CURNIN, ESQ., &
THOMAS J. KAVALER, ESQ.,
80 Pine Street,
New York, New York

APPEARANCES CONTINUED:

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HUNDLEY and CACHERIS, P.C.,
BY: WILLIAM G. HUNDLEY, ESQ.,
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Washington, D.C.

DILWORTH, PAXSON, KALISH &
KAUFFMAN
BY: THOMAS I. VANASKIE, ESQ.,
Penn Security Bank Building,
Scranton, Pennsylvania, and
BY: J. CLAYTON UNDERCOFLER, III, ESQ.,
2600 The Fidelity Building,
Philadelphia, Pennsylvania

(In Chambers, 9:05 a.m., Thursday, May 2, 1985.)

THE COURT: Good morning, gentlemen. Come on in and sit down. I asked you to come in this morning because I wanted to ask a few additional questions.

MR. MURRAY: Excuse me, Your Honor, before we proceed, we have two new additions to the group.

THE COURT: To the group, all right.

MR. MURRAY: And that is J. Clayton Undercofler, for the defendants.

THE COURT: How do you do.

MR. MURRAY: And Robert Ogren, who's the Chief of the Fraud Section --

THE COURT: How do you do, Mr. Ogren.

MR. MURRAY: -- the United States Department of Justice.

THE COURT: And, Mr. Murray, it concerns both the Information and the complaint for permanent injunction. Not too much on the complaint. But in the Information, on Page three, Paragraph six (a), where it says "branch," do you have that in front of you?

MR. MURRAY: I'm getting it right now. Page three, your Honor, did you say?

THE COURT: Yes, Paragraph six (a), "Branch office cashiers," do you have that?

MR. MURRAY: Yes, your Honor.

THE COURT: "Of the defendant Hutton Company were instructed to calculate, on a daily basis the net activity." The net activity meaning both collected and uncollected accounts?

MR. MURRAY: Meaning the net activity, all the debits and the various credits to the account on a single day, including also any wire transfers, out, or any wires in. So, yes, that would be --

THE COURT: Would that mean the net balance?

MR. MURRAY: Yes, your Honor, I believe so.

THE COURT: Okay. And on Page six, nine (b), "causing funds to be successively transferred between various branch and regional depository bank accounts of the defendant, Hutton Company, prior to their deposit in a prime depository bank," which, by way of example, would be Manufacturers Hanover or Bank of America?

MR. MURRAY: Yes, your Honor.

THE COURT: But had the cash desks already deposited the DTC's drawn on the regional accounts in the prime depository banks?

MR. MURRAY: All the activity would occur on the same day. So by the end of the day there would be a DTC or transfer check deposited in the prime location. During the day, however, the monies would be successively transferred interbranch, between the branches. The last activity [illegible] would be the deposit of the final concentration check into the prime account.

THE COURT: All right.

MR. CLARK: This is all activity, your Honor, being described in nine (b), which is taking place or was taking place prior to the time that the funds were transferred to the prime depository banks.

THE COURT: The example, Manufacturers Hanover, prior to the time it was manually delivered and deposited?

MR. CLARK: Manually in the case of the bank in New York.

THE COURT: And telex in the case of the Bank of America?

MR. CLARK: Yes.

THE COURT: The money, on Page seven, where there's reference to the zero balances, the amounts drawn on the zero balances, for example, at United States Trust, how and when would that be covered?

MR. MURRAY: Oh, that would be at the end of the day. Whenever the checks would be drawn on the zero balance account would be clearing through the accounts of United States Trust, or Chemical Bank, or Bank Of America, at the end of the day, in many instances, most instances, the bank would call Hutton, and Hutton would wire transfer funds in to cover the zero -- those checks clearing in the afternoon.

THE COURT: But the bank would only call if the amount was presented for payment?

MR. MURRAY: Then the checks would clear their bank, and be posted to the account.

THE COURT: And would there be any hiatus beyond one day in that?

MR. MURRAY: In certain circumstances there may have been, in this situation, a hiatus of one day in a delayed posting. Sometimes delayed posting happens as a result of clerical errors on the part of the bank, or other problems, say in coding of the check, or other -- the coding of the check is what identifies the account number. So on some occasions there could be a delay in the posting.

THE COURT: But that wouldn't be contemplated or anticipated?

MR. MURRAY: No, not by the banks, it would not, your Honor.

THE COURT: Okay. Well, how about by E. F. Hutton?

MR. MURRAY: We have not charged that in the Information, any contemplation by E. F. Hutton as far as delaying the posting of those checks, your Honor.

THE COURT: Now, in the complaint for permanent injunction, on Page six, and let me see what paragraph it would be. It would be thirteen (c), where, in the last sentence on the page, "In addition to the foregoing, the computations required to be made using the drawdown sheets provided that on certain days of the week." Were those predesignated days, such as a Friday?

MR. MURRAY: Yes, your Honor.

THE COURT: That would be Friday?

MR. MURRAY: There were other days during the week in which the various multiples or computations used to calculate the drawdown occurred, but they were designated, depending upon the calculation of the clearing time of the check.

THE COURT: But would it primarily be a Friday?

MR. MURRAY: Primarily a Friday, your Honor, and also on a Tuesday.

THE COURT: What would be the advantage on Tuesday?

MR. MURRAY: One is to -- on Friday is to create an overdraft during the weekend, or a holiday period.

THE COURT: Yes.

MR. MURRAY: And on many occasions in the drawdown sheet it occurred if there would be excess balances in the account from the weekend, these would also be pulled out.

THE COURT: What would be the advantage of doing it on Tuesday?

MR. MURRAY: Well, when you call the bank on a Tuesday, say checks taking two days to clear, deposited say Friday to become available on Tuesday, any excess balances that would be in the account from the weekend, if you multiplied the amount of the drawdown on that day, and pull an overdraft of the account on Tuesday, it would pull out excess funds that were left in the bank over the weekend.

THE COURT: In the final judgment that's been suggested for my signature, on Page two, Paragraph one mentions a permanent injunction as to violating Section 1341, "knowingly devising or intending to devise any scheme or artifice to defraud," et cetera.

Then on Page five, the second Paragraph of Section seven, it states, "the prohibitions described in Paragraphs '(2)' through '(7)' above shall take effect with the entry of this injunction; the prohibition described in Paragraph '(1)' above shall take effect within 90 days of this injunction." Why is that, what does it mean?

MR. CURNIN: Your Honor, that relates to Roman II, and the ordering paragraphs which appear in Roman II.

THE COURT: I'm sorry. All right, it refers to Roman II?

MR. CURNIN: Yes, it does, your Honor.

THE COURT: All right. I misread that, I thought it was to Roman I.

And the plea agreement itself, at least I couldn't find it, where it made any reference to the permanent injunction, or the agreement to consent to a permanent injunction.

MR. CLARK: Your Honor, the two proceedings, the criminal proceeding and the civil proceeding are distinct. The contemplation of the parties is, of course, that the civil complaint will be filed with the Court at the same time as the Information. And as soon as possible, at the conclusion of the Rule 11 proceeding, the parties would ask the Court to enter the final judgment of permanent injunction.

THE COURT: But it was intentional, therefore, to exclude from the plea agreement any reference to the civil action?

MR. CLARK: Yes, your honor, because there is a separate consent and undertaking executed by the broker/dealer defendant and the parent corporation.

THE COURT: Okay. Well --

MR. CLARK: There is reference, your Honor, in the plea agreement --

THE COURT: -- maybe I missed it.

MR. CLARK: -- to some of the items of relief that are requested in the government's civil complaint. But the two proceedings are not linked in the sense that the defendant in the plea agreement binds itself in the plea agreement to enter into the consent and undertaking. The consent and undertaking and the plea agreement are simultaneous documents.

MR. CURNIN: Your Honor, in the plea agreement itself, in Paragraph ten, your Honor -- Paragraphs five and six on Pages nine and ten, refers to the "Attendant civil injunctive proceeding."

THE COURT: Yes.

MR. CURNIN: And the relationship that exists between the criminal and the civil injunctive proceeding, in that certain papers that will be entered in that civil matter will be distributed as provided for in Paragraphs five and six on Pages eight and nine -- excuse me, nine and ten --

THE COURT: Nine and ten.

MR. CURNIN: -- of the plea agreement.

THE COURT: I know it's also mentioned in Paragraph (g) --

MR. CURNIN: Paragraph seven.

THE COURT: Or Paragraph four (g) it makes reference to "the acts and practices which are the subject of the Information herein or of the complaint filed in the attendant civil injunctive proceeding." But I construed, not that it concerns me, I construed Paragraph four to involve the implementation, rather than the substantive agreement of the plea agreement.

MR. MURRAY: Yes, your Honor.

THE COURT: I don't have any problems with it, I just wondered why there was no reference to it.

Well, I have nothing further. Does anybody else?

MR. MURRAY: No, your Honor, thank you.

MR. CLARK: No, your honor.

MR. CURNIN: Thank you, your Honor.

THE COURT: Do you want to go into Court?

MR. MURRAY: Sure, your Honor. May we have five minutes?

THE COURT: Sure, you let me know when you're ready.

MR. CLARK. If your Honor wishes to file the papers at the beginning of the Rule 11 proceeding--

MR. MURRAY: Or file them now.

MR. CLARK:: -- or file them in Chambers now? Or step down to the Clerk's office and file them?

THE COURT: Maybe you ought to file them in the Clerk's Office.

(9:20 a.m., Court concluded in Chambers.)

* * * * *

CERTIFICATE

I hereby certify that the proceedings are contained fully and accurately in the stenographic notes taken by me during the hearing of this matter, and that this copy is a true and correct transcript of my said notes.

Official Court Reporter

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

- - - - - - - - - - - - - - - - - - -x
UNITED STATES OF AMERICA, :
:
v. : CRIMINAL NO. 85-00083
:
E. F. HUTTON AND COMPANY, INC., :
Defendant. :
- - - - - - - - - - - - - - - - - - -x

BEFORE: HONORABLE WILLIAM J. NEALON,
Chief Judge,
United States District Court,
For the Middle District
of Pennsylvania,
Guilty Plea,
at Scranton, Pennsylvania,
on, Thursday, May 2, 1985.

APPEARANCES:

FOR THE GOVERNMENT: ALBERT MURRAY, ESQ.,
Assistant United States Attorney,
Scranton, Pennsylvania

ROBERT OGREN, ESQ., &
PETER B. CLARK, ESQ.,
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FOR THE DEFENDANT: CAHILL GORDON & REINDEL
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80 Pine Street,
New York, New York

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DILWORTH, PAXSON, KALISH &
KAUFFMAN
BY: THOMAS I. VANASKIE, ESQ.,
Penn Security Bank Building,
Scranton, Pennsylvania, and
BY: J. CLAYTON UNDERCOFLER, III, ESQ.,
2600 The Fidelity Building,
Philadelphia, Pennsylvania

(In open Court, 9:35 a.m., Thursday, May 2, 1985.)

MR. MURRAY: Good morning, your Honor.

THE COURT: Good morning.

MR. MURRAY: Your Honor, before we begin, I believe we have some admissions to make to the Court.

THE COURT: Mr. Vanaskie.

MR. VANASKIE: Yes, sir. Your Honor, pursuant to Local Rule of Court 202.3, I respectfully move for the admission Pro Hac Vice of counsel for E. F. Hutton, Thomas Curnin of the Cahill firm, Thomas Kavaler of the Cahill firm, and also Mr. Thomas Fitzpatrick. All are members in good standing of the Bar of the Court of Appeals of New York.

I wold also like to move for the admission of William Hundley, on behalf of Hutton, who is a member in good standing of the Bar of the District of Columbia; and also would like to move for the admission, Pro Hac Vice, of J. Clayton Undercofler, a member of our firm, the Dilworth firm, who is a member in good standing of the Supreme Court of Pennsylvania.

THE COURT: Thank you very much. So ordered and happy to have you, gentlemen.

MR. MURRAY: Your Honor, also, the United States would move for the the admission of Robert Ogren, who is the Chief of the Fraud Section of the United States Department of Justice, and a member of the Bar of New York State, and also Peter F. Clark, who is a trial attorney with the United States

Department of Justice, assigned to the Fraud Section.

THE COURT: All right, so ordered and the same comments apply.

Initially, Mr. Murray, I would like to explain, for the record, that we have held three In Camera conferences that were requested by the government and by --

MR. MURRAY: That's correct, your Honor.

THE COURT: -- by counsel for the defendant. And they were held on April the 30th, May 1st, and again this morning, on May 2nd. And I'll similarly order that the Court Reporter file transcripts of these conferences as part of the record in the case when they're completed.

So, with that, you may proceed.

MR. MURRAY: Thank you, your Honor.

Your Honor, today the United States Government has filed several actions with the Court. The first being Criminal Number 85-00083, which is an Information filed by the United States Attorney for the Middle District of Pennsylvania, captioned United States of American versus E. F. Hutton and Company, Inc.

Along with that Criminal Information, which charges violations of 18 United States Code, Section 1341, which is mail fraud, and 1343, the government has filed a notice of plea agreement, and plea agreement.

We have also filed a complaint for permanent injunction and ancillary relief, which is filed to Civil Action Number 85-0601.

We have also filed with the Court a consent and undertaking of E. F. Hutton Group, Inc, and E. F. Hutton and Company, Inc., which is a part of the complaint for permanent injunction and ancillary relief, and also a final judgment of permanent injunction against -- a proposed order, that is, for final judgment and permanent injunction against E. F. Hutton Group, Inc., and E. F. Hutton and Company, Inc.

Your Honor, before we proceed in this matter, it's necessary, under Federal Rules of Criminal Procedure, Rule 7(a), normally that a matter which charges against a corporate defendant or an individual defendant, there's a right to have that matter presented to a Grand Jury for indictment purposes, since felony violations are charged. However, a defendant may waive the right, his rights under Rule 7(b) of the Federal Rules of Criminal Procedure.

In this matter, your Honor, there is plea agreement, which has been filed with the Court and been executed by all the parties in this matter. And as a part of that plea agreement, the Defendant, E. F. Hutton and Company, Inc., has executed today, a waiver of indictment, pursuant to Rule 7(b), which I presently have in my possession, and we'd like to present to the Court.

And I would also ask that Mr. [illegible], I believe, and Mr. Hundley would approach the bench also.

THE COURT: All right. May I see it, please?

How about, don't you think the representative of the corporation should make the waiver?

MR. MURRAY: May I see that, your Honor, please?

Thank you. That's true.

MR. CURNIN: Mr. Pierce will sign on behalf of the defendant company, your Honor.

MR. MURRAY: Mr. Pierce is the President of E. F. Hutton and Company, Inc.

(Mr. Pierce signed document.)

MR. MURRAY: Your Honor, the waiver has been executed and reads as follows: "United States of American versus E. F. Hutton and Company, Inc., Criminal Number 85-00083." The violations are 18 United States Code, Section 1341, mail fraud, and 18 United States Code, Section 1343, wire fraud.

The waiver reads, "E. F. Hutton and Company, Inc., the above named defendant, who is accused of violations of 18 United States Code, 1341 and 1343, being advised of the nature of the charge and of its rights, hereby waives, in open Court, prosecution by indictment, consents that the proceeding may be by information instead of by indictment."

It's signed by counsel for the defendant, Thomas F. Curnin, the firm of Cahill Gordon & Reindel, and also [illegible].

Hundley, counsel for the defendant, and also by Mr. Scott Pierce, who is the President of E. F. Hutton and Company, Inc., which is a Delaware corporation.

THE COURT: I'll address myself to Mr. Pierce. Mr. Pierce, you understand, do you, that normally the government is obligated to present any criminal charges to a Grand Jury, which may or may not indict the corporate defendant.

However, as Mr. Murray has explained, the Criminal Rules provide that a defendant may waive presentment of this matter before the Grand Jury, which, in effect, would concede that if the charges contained in the Information were presented to the Grand Jury, that the Grand Jury would indict under those particular charges. Do you understand that?

MR. PIERCE: I do, your Honor.

THE COURT: All right. And that by signing this waiver you acknowledge that the Grand Jury would have indicted on these particular charges, and that you agree, on behalf of the corporation, to proceed by waving this right, and proceed to respond to the Information?

MR. PIERCE: I do, Your Honor.

THE COURT: You understand, all right.

MR. MURRAY: May I proceed, your Honor?

THE COURT: Yes. Perhaps I should have asked that you -- I mentioned the three In Camera hearings that we had.

MR. MURRAY: Yes, your Honor.

THE COURT: And I think it might be appropriate if you would explain, for the record, why it was believed by government counsel and defense counsel that an In Camera discussion should occur prior to the filing of the Information and the related documents.

MR. MURRAY: On behalf of the government, your Honor, we made that request as a result of prejudice that might result to the ongoing and pending Grand Jury proceedings, which are currently being conducted in the Middle District of Pennsylvania, and, specifically, the City of Harrisburg. I hope I'm accurate, but the Grand Jury Number is 83-142.

A public disclosure of the documents that were filed in this matter, the Information, the plea agreement, the complaint, and other matters would have severely prejudiced the Grand Jury's inquiry, in the event that a successful plea was not entered and not accepted by the Court, since this is a type of an agreement, under 11(e)(1)(C), which must be accepted by the Court.

Also, because of the fact that E. F. Hutton and Company, and its parent corporation, E. F. Hutton Group, Inc., is a publically held corporation, we would have anticipated widespread publicity, which would have, in fact, caused prejudice not only to the government but also to E. F. Hutton.

We would believe, in the best interests of the government, to have this matter sealed at the time of the filing

best copy available

of these papers, which have some complex matters in them, and we wanted an opportunity to review that with the Court.

THE COURT: All right.

MR. MURRAY: That was on behalf of the government.

THE COURT: Would you agree with that statement, counsel?

MR. CURNIN: Your Honor, we join in that statement insofar as it applies to the defendant.

THE COURT: All right, you may proceed, Mr. Murray.

MR. MURRAY: Your Honor, normally at this time we would proceed to the arraignment on these charges.

THE COURT: Okay.

MR. MURRAY: Basically I would like to ask, well, indicate to the Court, that the Information which has been filed charges the Defendant, E. F. Hutton and Company, Inc., with violations of 18 United States Code, Section 1341, and 1343, in a 2,000 count Information, alleging a fraudulent activity involving numerous banks throughout the country, occurring between July 1st, 1980 and February 28th, I believe, 1982.

And I'd like to ask the defendant, who is represented by counsel, and present, whether they've had an opportunity to receive a copy of the Information which has been filed?

MR. CURNIN: Yes, Your Honor, we have.

THE COURT: I think we should proceed with the arraignment and the plea colloquy.

MR MURRAY: At the same time, okay.

THE COURT: Yes.

MR. MURRAY: And also whether or not the company has had an opportunity to understand the nature of the charges, and request that I read the charges, or that they waive reading of the actual Information?

MR. CURNIN: The company is aware, understands the nature of the charges, and we waive the reading of the Information.

THE COURT: Fine.

MR. MURRAY: Your Honor, as a part of this Information, there is a notice of a plea agreement, and a plea agreement which is filed in this matter. If the Court would like for me to explain the nature of the plea agreement --

THE COURT: No, I would prefer going with the arraignment and plea colloquy first, then get into the plea agreement, and then get into your explanation as to the factual background of the case.

MR. MURRAY: All right.

THE COURT: So if counsel and Mr. Pierce would approach the Bench, we'll proceed with the colloquy.

MR. MURRAY: I would then ask whether or not the Defendant, E. F. Hutton and Company, Inc., by Mr. Pierce, is present, and desires to enter a plea to the Information that has been filed in that?

MR. PIERCE: Yes, we do.

THE COURT: All right. The Court is obligated to conduct a colloquy with the defendant in criminal cases, and to explain the rights of a defendant, Constitutional and otherwise, to be satisfied that the plea is voluntary, and also that there is a basis in fact for the plea.

Admittedly, in this type of proceeding, under Rule 11(e)(1)(C), the colloquy might appear to be somewhat awkward, but, nevertheless, the Court believes itself bound to proceed with the colloquy in the same manner as any other case at the time of the arraignment and the indication by a defendant that a guilty plea will be entered.

So, Mr. Pierce, it's Scott Pierce, is it?

MR. PIERCE: Yes, sir.

THE COURT: And you are President of E. F. Hutton Company, Inc?

MR. PIERCE: Yes, sir.

THE COURT: E. F. Hutton and Company, Inc., is that the correct designation?

MR. PIERCE: That is correct, Your Honor.

THE COURT: And I understand that you have been authorized by the corporation to enter a plea of guilty to the charges in the Information on behalf of the corporation?

MR. PIERCE: Yes, sir.

THE COURT: And has that resolution been made a part of the record?

MR. MURRAY: Yes, it has, your Honor, I believe. Or the paper's filed.

MR. [illegible]: Yes, your Honor.

THE COURT: And it is the desire of the corporation, through you, to enter a plea of guilty, is that correct?

MR. PIERCE: Yes, your Honor.

THE COURT: All right. Now, before accepting the corporation's plea, I must ask you, as its representative, certain questions, to be assured that it is a valid plea. And if you don't understand any of my questions, or you wish to consult with your counsel, just say so, since it's essential to a valid plea that you understand each question before you answer. Do you understand that?

MR. PIERCE: Yes, [illegible].

THE COURT: All right. And I must advise you further that I am going to place you under Oath, and if you answer any of my questions untruthfully you may be charged with perjury or with making false statements. Do you understand that?

MR. PIERCE: Yes, your Honor.

THE COURT: Are you agreeable to taking an Oath?

MR. PIERCE: Yes, your Honor.

THE COURT: Would you raise your right hand, please.

Do you swear by almighty God, the searcher of all hearts, that the answers you're about to give to the questions posed by the Court will be the truth, the whole truth, and nothing but the truth, so help you God?

MR. PIERCE: Yes, your Honor.

THE COURT: All right. Now, Mr. Pierce, within the past 24 hours have you taken any drugs or medicines or consumed any alcoholic beverages?

MR. PIERCE: Yes, your Honor.

THE COURT: And what would they be?

MR. PIERCE: I had two drinks last night, Judge.

THE COURT: I see. The reason for my asking that, it's a prerequisite to taking a plea, is to be satisfied that a defendant, or, in your instance, one appearing on behalf of the defendant, understands the proceedings and can respond intelligently to my questions.

It has occurred, in some instances, where a defendant, post-sentence, will say that at the time of the plea he was under medication or he had been consuming alcoholic beverages or other drugs and consequently could not understand the full nature of the proceedings and the questions that were being propounded to him. Do you understand that?

MR. PIERCE: I do understand, sir.

THE COURT: Can I be satisfied that you do understand the nature of these proceedings, and why you're here, and that you can respond intelligently to my questions?

MR. PIERCE: Yes, your Honor.

THE COURT: All right. Now, on behalf of the corporate defendant, can you tell me, for the record, that you've had ample opportunity to discuss this case with counsel for the corporation, and that you are satisfied with counsel's representation of you?

MR. PIERCE: Yes, your Honor.

THE COURT: All right. And I must now advise you of certain rights that the corporation has. For example, the corporation/defendant does not have to enter a plea of guilty today to this Information. You understand that, don't you?

MR. PIERCE: I do. I do, your Honor.

THE COURT: And if the corporation enters a plea of not guilty, do you understand that unless the government moves to dismiss the charges without prejudice, and the motion is granted, the Court will fix a speedy trial date for trial by jury of the charges contained in the Information. Do you understand that?

MR. PIERCE: I understand that, your Honor.

THE COURT: All right. And at that trial the corporate/defendant would be presumed to be innocent and the government would have to prove its guilt by competent evidence and beyond a reasonable doubt before it could be found guilty, and the corporation would not have to prove that it was innocent of the charges contained in the indictment. Do you understand that?

MR. PIERCE: I do understand, yes.

THE COURT: In other words, there's no burden upon any defendant to prove its innocence, or to, indeed, offer any evidence in defense of the charges. Do you understand that?

MR. PIERCE: I do, your Honor.

THE COURT: Okay. And I mentioned reasonable doubt. A reasonable doubt is defined in the law as being such a doubt as would cause men and women acting in their everyday affairs of life to pause and to hesitate before coming to a decision in a matter of great importance to themselves. Do you understand that?

MR. PIERCE: I do, yes, sir.

THE COURT: All right. At the trial the corporation would be entitled to be represented by counsel, and through counsel to confront and cross examine any witnesses who might appear to testify against the defendant. Do you understand that?

MR. PIERCE: I do, sir.

THE COURT: And at trial the defendant would also be entitled to have witnesses summoned, by subpoena, to appear and testify on its behalf if so desired. Do you understand that?

MR. PIERCE: I do, sir.

THE COURT: All right. Also at the trial, no corporate officer or employee or agent would be required to testify, and perhaps compelled to incriminate himself. In other words, there would be no requirement at trial that anyone testify on behalf of the corporation. Do you understand that?

MR. PIERCE: I do, sir.

THE COURT: Now, obviously these rights that I've just explained to you contemplate a jury trial, but if the defendant enters a plea of guilty to the charges contained in the Information, there will be no trial, and the defendant, in effect, will have waived or surrendered these Constitutional rights. Do you understand that?

MR. PIERCE: I understand that, your Honor.

THE COURT: And on behalf of the defendant corporation do you still wish to enter a plea of guilty?

MR. PIERCE: I do, sir.

THE COURT: All right. Now, has anyone persuaded or induced you, or the corporation, you on behalf of the corporation, to enter a plea of guilty today?

MR. PIERCE: No, sir.

THE COURT: Has anyone threatened or coerced you in any way, on behalf of the corporation, to enter a plea of guilty?

MR. PIERCE: No, sir.

THE COURT: Then can I be satisfied that the defendant's decision to enter a plea of guilty is a voluntary one?

MR. PIERCE: Yes, sir.

THE COURT: All right. Perhaps now would be --

MR. MURRAY: Excuse me, your Honor, the fine provisions would be $2,000,000.00, in the event that --

THE COURT: All right. As government counsel has pointed out, under Section 1341 and 1343, inasmuch as it is a corporate defendant, the maximum punishment on each count would be a fine of $1,000.00. Do you understand that?

MR. PIERCE: I do, sir.

THE COURT: I think maybe this would be an appropriate time for you to discuss the plea agreement and give the background of the case.

MR. MURRAY: Would you like me to give the background of the case first or the plea agreement?

THE COURT: Which do you think might be more orderly? Perhaps the background.

MR. MURRAY: The background. I'll try to be brief but the Court knows how I am.

Your Honor, this matter, this investigation commenced --

THE COURT: What I would like you to cover, too, is, not only the background, so that I won't have to interrupt you, but when I say the background, the investigation, the Information, the plea agreement, the civil proceedings, the reason why individuals were not charged, and why the government believes that the Court should accept a Rule 11(e)(1)(C) disposition of this case.

MR. MURRAY: And would the Court like me to give an offer of proof at some subsequent time, or would you like me to include all of that at one time?

THE COURT: Can you include it all?

MR. MURRAY: I can try, your Honor.

THE COURT: All right, you follow the format that you think is most comfortable.

MR. MURRAY: And if I'm confusing to the Court, the Court can just tell me and I'll change directions.

Your Honor, generally, this matter was brought to the attention of the government on March 19th of 1982 by bank examiners of the FDIC, or Federal Deposit Insurance Corporation, who forwarded a report to the United States Attorney's Office for the Middle District of Pennsylvania, and other offices throughout the -- in other districts, regarding certain irregularities in E. F. Hutton and Company's bank accounts at the United Penn Bank in Wilkes-Barre, Pennsylvania, which is located in --

THE COURT: I might ask, and I regret interrupting you again. I know counsel will be listening, but I'd want Mr. Pierce, because he's appearing on behalf of the corporate defendant, to listen to Mr. Murray's statements, as I may ask you if you agree or disagree with what he represents, or if there is any comment you'd care to make concerning them.

MR. MURRAY: Your Honor, this report by the FDIC, was subsequently brought to our attention by the United States Postal Inspection Service. And on April 14th, 1982, this matter was opened officially as a file by the United States Postal Inspection Service. And on or about May 10th of 1982, was opened by the United States Attorney's Office for the Middle District of Pennsylvania.

At that point in time our office started to conduct a Grand Jury investigation, and that investigation was handled in Harrisburg, Pennsylvania, into possible violations of the mail fraud and wire fraud statutes by E. F. Hutton and Company.

The crux of the complaint was that there was a suspected check kite being perpetrated at the United Penn Bank, involving several other banks. That being Genesee Country Bank, in Batavia, New York, American Bank and Trust Company in Reading, Pennsylvania, the Bank of New York involved, in White Plains, New York, Manufacturers Hanover Trust Company in New York, Chemical Bank in New York, United States Trust Company of New York, which is located in New York, Chase Manhattan Bank in New York, and several other banks in New York City and throughout the country.

As a result of this inquiry, this investigation was conducted in, maybe I've mentioned this already, in Harrisburg, Pennsylvania, and this investigation is still ongoing. There were also reports, as a result of Grand Jury Subpoenas, received from the New York State Banking Commission, and also from the Federal Reserve Bank of New York, and other banks regarding this suspected activity.

This Grand Jury investigation has continuously been pending since May of 19 -- really, April of 1982, and our office has handled this matter. Generally, we have issued over 300 Grand Jury Subpoenas throughout the country to various banking institutions, various employees of E. F. Hutton and Company, and various regulatory agencies.

Basically, the Grand Jury investigation revealed that E. F. Hutton and Company was involved in a nationwide scheme involving its cash concentration system to overdraft its bank accounts to create float within the payments mechanism system of the Federal Reserve, and also various banking institutions.

These banking institutions, basically in the Middle District of Pennsylvania, which afforded the initial jurisdiction and venue, was United Penn Bank in Wilkes-Barre, Pennsylvania, was Commonwealth National Bank in Harrisburg, Pennsylvania, and also Northern Central Bank in Williamsport, Pennsylvania.

As a result of the investigation, which was expanded throughout the country over the past three years, the Grand Jury's investigation basically revealed, and our evidence would show, basically that there were some 300 odd banks, excuse me, approximately 400 odd banks affected by this conduct, which is the subject of the Information.

As a little background, the Department of Justice, United States Department of Justice in the past year, because of its interest in protecting the integrity of the banking system, and because of the nature of the charges against a public corporation, or, excuse me, of E. F. Hutton and Company, took over supervision of this case, and the case was supervised by Stephen Trott, the Assistant Attorney General, and by Robert Ogren directly, Chief of the Fraud Section, who was responsible actually for the investigation, Peter Clark, trial attorney for the Fraud Section, and myself.

During the course of the three years, our district engaged in numerous discussions with Mr. Curnin, representing the corporation, in relationship to a potential plea agreement on the part of the corporation, which has been codified within these papers. This matter has been reviewed by the Department of Justice; by our office; has been, as I understand, well, I know, over the past year, has been the subject of numerous discussions within the company and the government in relationship to this matter.

We have attempted in the Information to outline the conduct that is the subject of the criminal charges occurring between this period. And that is July 1st, 1980 and February 28th, 1982. As the Court will see, the plea bargain agreement has provisions in it for the E. F. Hutton and Company to waive venue, and indictment, and to pled guilty to 2,000 counts. And those counts will be representative of activities occurring across the country.

THE COURT: Are you going to --

MR. MURRAY: In the Middle District and across the country, excuse me. Maybe I've been too verbose.

THE COURT: No, you haven't at all. Maybe too generalized. Could you give an example, or explain how the scheme operated.

MR. MURRAY: Okay. Your Honor, I'm going to go into, really, the offer of proof of what our evidence would show, if the Court wouldn't mind.

The government's evidence generally would show that between the period mentioned, July 1st, 1980 and 1982, Hutton and Company, which is a Delaware corporation, and doing business in New York, and it's the second largest independent broker/dealer in the country, and in securities, and Hutton Group, which is its parent, which is a publicly held corporation, was divided and operated at this point in time.

organizationally, in 300 branch offices throughout the country.

The Hutton Company, and which is the subject of this proceeding, took in from its customers an average of between $40,000,000.00 and $200,000,000.00 a day from customers that it serviced, both individually and from the institutional standpoint.

These 300 branches throughout the country, your Honor, were staffed, the local branches were staffed by different categories of employees. And, specifically, they were staffed by branch operations -- branch office managers, rather, branch operations managers, and branch cashiers, and I'll get into a further explanation of that.

Basically, these 300 branch offices throughout the country were divided into nine geographical regions covering the United States. These regions were basically in Boston, New York, Atlanta, Chicago, Kansas City, Missouri, you've got Houston, Texas, Denver, San Francisco, Los Angeles, and there's also a tenth regional area, and that's in Geneva, Switzerland. That's the international region.

So these various regions, which are depicted on this, illustrated on this map here, were set up for the purposes of servicing the various branches, the operating branches of E. F. Hutton and Company.

In order to basically operate its business, the corporation needed to have access to the [illegible] and [illegible] that it would receive from its customers in these various 300 branches. Each one of the branches had a bank account. Each one of the nine operating domestic regions had a bank account. What would occur, is that monies that would be received by the local branch offices would be deposited by branch personnel into the approximately 400 bank accounts of the company.

All of that income would then be funneled and concentrated, and this is what's called a cash concentration system, which is the subject of the criminal charges into these nine operating regions.

What would occur --

THE COURT: Did the regional offices, you say they had separate bank accounts, did they have sources of funds other than from the branch accounts?

MR. MURRAY: Some regional offices did, your Honor, but their main source of the funds would be monies received from the local branch accounts. I failed to mention that the regional service centers, or operating regions also had regional vice presidents, and a regional operations manager, and a regional cashier, whose function was to, in this system, is to transfer, really, monies from the regional bank account.

So what we have, in a little summary, is we have 300 to 400 branches throughout the country; we have nine operating regions, each with a bank account; all of the local regions with a bank -- branches with a bank account; and [illegible] two prime bank accounts located, one in the east coast, and that bank account was Manufacturers Hanover Trust Company, and another bank account on the West Coast, which was Bank of American.

The purpose of these accounts were to concentrate, to further concentrate the funds that had been transferred from the branch to the region, and then into these prime locations for the purposes of investment by the company. The purpose --

THE COURT: Up to this point there's nothing wrong with that, is there?

MR. MURRAY: There is nothing wrong with that. This is a standard method of cash concentration by major corporations in the country. Major corporations with multiple branch locations must funnel their money, in outlying locations, as quickly as possible to the investment points. And this is what is called a cash concentration system.

The accounts that were utilized, that are utilized in this transfer of funds on a daily basis, and we're talking generally about all of the transfer of monies occurring on a one-day basis, the type of account is a demand deposit account. That's generally known as just a normal checking account.

And the way in which monies are transferred in this particular system, which is the subject of the Information, is via of what we call a depository transfer check. And it's exactly what it states. It transfers a deposit from one location to another. So in a standard system you would have a check withdrawing funds from the local branch account, concentrating those funds and funneling them into these nine branch regions via a transfer check. And then further channeling those funds into prime location accounts as a result of a depository transfer check.

The local cashier at the branch level, and the regional cashier would transfer money from the branch, and a cashier at Hutton headquarters in New York would write a check and deposit those funds in the prime concentration account.

MR. CLARK: Excuse me. And, your Honor, the government's evidence would show that it was the reasonable expectation of the defendants branch depository banks that the funds received by the defendant from its customers would be transferred and concentrated into other banks accounts, and ending up in prime depository accounts of the defendant.

THE COURT: Let me ask this. On a daily basis --

MR. MURRAY: Yes, your Honor.

THE COURT: -- how much of its bank account would the branch office transfer to the region?

MR. MURRAY: All of it, your Honor.

THE COURT: All of it.

MR. MURRAY: All of the funds that it received on a daily basis.

THE COURT: Okay.

That only customer monies would be going into these local depository accounts, and that these customer funds would be received in the ordinary course of business.

It was also the local bank's expectations throughout the country, that the funds that would be withdrawn from these local banks to the regional concentration banks, and then eventually concentrated to the prime banks, would be available funds, or actual funds that are either collected -- checks that are collected through the banking system, or the bank, by agreement, makes the funds available to the company.

Hutton, during peak periods between 1980 and the time that's charged in the actual indictment, excuse me, Information, during peak periods of high interest rates, where the interest rates ran approximately between 18 percent and 20 percent on, commenced a scheme to write checks that were far in excess of the actual customer receipts that it obtained in the legitimate course of business. In other words, they overdrafted their bank accounts in large amounts in order to obtain the use of these monies.

Now, when we're talking overdrafting the bank accounts, we're talking about actually overdrafting Hutton's books by writing a check in excess of the money then located in the actual bank account at the time the check was actually written.

THE COURT: And this was done initially at the

MR. MURRAY: Okay. Your Honor, the second method in cash concentration, there is not only a depository transfer check between two points, but also it can be done by a wire transfer, electronic funds transfer. It s called EFT. That causes an instantaneous transmittal of a deposit from one location to the next.

A check, which is used to transfer funds from one location to another, which goes into the payments mechanism system, must clear the various banking channels, Federal Reserve banking channels and also any local clearing houses that are utilized for the purposes of clearing checks. That is a standard method of operation.

What is charged, however, in the scheme, is this, your Honor. We are interested mainly and solely --

THE COURT: Excuse me. The prime account would receive then, total daily, or would deposit total daily amounts?

MR. MURRAY: That s correct. Maybe I can give an example. I'm try and be brief.

If there are five branches within a region, and this is, for instance, the Southeast region, each branch receiving $100.00. Or a total of -- each branch would have in it's bank account $100.00. It would transfer, on a daily basis, and funnel that $100.00 to a regional account. So that regional account would show $500.00.

That regional account, on that same day, via the wire, would wire New York as to the amount that it had in its bank account, which would be $500.00, and then transfer that $500.00 to New York. That $500.00 then would be used, basically since it was by a check, the next day by the company for investment. So within the system you would have a $500.00 amount showing in the prime concentration bank, a $500.00 amount in the regional, and $500.00 in the various branches.

Your Honor, the Information charges, and our evidence will show, that E. F. Hutton and Company, Inc., abused the cash concentration process; deviated substantially from the normal method of withdrawing of these funds, and the concentration of these funds into these various prime locations.

The deviation and the fraudulent conduct which was a part of this scheme, caused the banks to lose substantial sums of money and to be exposed to various financial risks of harm. While benefiting Hutton in this way, your Honor, Hutton, by the scheme, and I'll identify it in a few seconds, obtained the use of interest free bank funds. And I'll describe that very, very shortly.

It was the company's expectation -- excuse me, it was the local bank's expectation in this system that the checking accounts that were used by E. F. Hutton for the consolidation of its customer funds, it was the bank's expectation that Hutton would merely be transferring funds legitimately received from customers, from one bank to the next.

branch?

MR. MURRAY: At the branch level. Then it was also done at the regional level, within the cash concentration system. They did this in the sum of approximately $200,000,000,00 to $250,000,000.00 per day on certain situations. To cover these overdrafts, what Hutton did, fraudulently, and against the normal business expectation that a banking institution would have, is they utilized Hutton to Hutton checks, which Hutton called branch reimbursement checks, for the purposes of covering the overdrafts that they had initially created. In essence what occurs, your Honor, is that Hutton initially concentrates an overdrafted sum of money on day one, and then covers on day two or day three that overdrafted amount, that excess amount.

THE COURT: Covers it how?

MR. MURRAY: Covers it with a Hutton to Hutton check, with a check drawn on an account -- on Hutton's account. It did not cover -- it covered a portion with customer funds, and I'll have examples of that, but the majority of the funds, the overdraft, as I'll illustrate --

THE COURT: Would the covering check also be an overdraft?

MR. MURRAY: Your Honor, the covering check was drawn on a -- it covered the overdraft. The covering check was drawn on what we call a zero balance account.

THE COURT: Okay.

MR. MURRAY: In financial circles a zero balance account is the same thing as a demand deposit account. It's a checking account. But what occurs is that it doesn't have to be in balance in that account at the time the check is written, and need only be a small balance, or what we call an imprest balance at the time.

The legitimate corporate financial purpose for the use and the bank's expectation in this matter, and the banks were, the Chemical Bank in New York, the Bank Of America in California, and the United States Trust Company in New York, in which Hutton maintained these zero balance accounts. The stated purpose of these accounts, and the legitimate business purpose for these accounts would be that these zero balance accounts would be used to pay customers, would be used to cover cashiering errors, or be used to pay vendors of the company.

In violation of that agreement and understanding, or implied understanding with the banks in which they maintained these accounts, Hutton and Company used those checks to cover the overdrafts that it initially created on day one.

THE COURT: Would the volume be increased to such an extent that the three banks would be put on notice at all that there was something funny going on here?

MR. MURRAY: It was the expectation of the banks, and based upon the credibility of E. F. Hutton and Company, and based upon their credit worthiness, and based upon their reputation, that these accounts would be only used for limited purposes, and that is to cover customer monies, for errors, et cetera. Many of the banks do not have the ability to pick up this activity, to know what the actual intent of the company was at the time the check was written.

THE COURT: But the volume wouldn't be so disproportionate between the purpose for which it was used here and the purpose for which it was intended, that there would be a red flag to the banking institution?

MR. MURRAY: Well, the banking institution, many of the local banks, and I might digress just one second here, there are 14,700 banks, commercial banks throughout the country, of which 11,000 are very small country banks. Many of the country banks would not know, or could not pick up the activity occurring in the account. Mnay of the larger banks would see the activity occurring, but did not know Hutton's intent.

THE COURT: I'm talking about the three zero balance banks.

MR. MURRAY: Yes. Because of the large volume of Hutton business, they did not know, and the evidence will show that they did not know that these accounts were being used for the purposes of covering overdrafts. It was their understanding that it was being used to either pay customers, to cover cashiering errors, or cover bounced checks, et cetera, but not for the purpose of --

THE COURT: But these would be very active accounts then --

MR. MURRAY: Yes, they would.

THE COURT: -- on a daily basis?

MR. MURRAY: They would be transferring millions of checks within the course of a month. In essence, what occurred, is that as the result of the use of these zero balance accounts, it created a circle of money. The zero balance checks would go into the local depository to cover the initial overdraft, and then would be presented to the zero balance banks. Excuse me.

I may have made a misstatement. I don't believe that millions of checks went through the zero balance account. That's my error. During the course of this activity, there were billions of dollars of zero balance checks used to cover overdrafts, but not that the volume of checks was such to be millions, your Honor.

THE COURT: Okay.

MR. MURRAY: So, pardon me, that I made that error, please.

Another part of the scheme was that by the inclusion of these checks to cover these large overdrafts, which bore no relationship to the customer money, by having these checks being drawn upon different locations, they crossed the Federal Reserve, and they went into the Federal Reserve patterns mechanism. And, as a result of that, they affected the Federal Reserve.

If I can be brief, the Federal Reserve System basically has a system whereby it clears checks, regional processing centers. Any check that goes interterritorial between the twelve Federal Reserve Districts, obviously it will take a time for it to clear the various banks. In other words, if you write a check on a West Coast bank, and deposit in it an East Coast bank, there s going to be a clearing time. As a result of this scheme, millions of -- billions of dollars of illusory funds went through the Federal Reserve System and possibly had an affect on it, or had and affect on it.

The company also engaged in a practice of drawing against uncollected funds, and generally that just means that it drew out monies quicker than it actually cleared the banking system. And when it does that, it leaves no money in the bank, and therefore the banks would have suffered an out-of-pocket loss for the bank services that would be rendered, and also the investment loss of the funds, since those funds would be used now by Hutton, and would be used by Hutton to obtain interest free bank loans.

There was also, which is part of the Information, a technique which was used by Hutton to create additional -- to delay the detection of the overdraft by using multiple deposit locations. And I have illustrations of this, in a second, and

I'll try to be again brief for the Court, but specific.

THE COURT: That s all right.

MR. MURRAY: What the company would do is, if it overdrafted its bank account, in other words draft checks, overdraft its books, it would always cover the bank from being overdrafted by depositing these zero balance accounts. But it would then overdraft it's books, and then in order to delay the clearing time of these checks, it would deposit funds in multiple locations.

Instead of, as I mentioned in the first part of my conversation, depositing a check in a local depository, and transferring it to a regional bank, and then to a prime bank, it would deposit funds in a branch account, and then have another branch account draw those funds down, and then another branch account draw those funds down. What we call interbranch transfers.

As the branch locations are multiplied, so are the funds that are represented in the checks that are used to transfer these accounts. That deviation was for the purposes of extending the period of time for the collection of these funds. And, therefore, would extend the period of time that the company would have use of bank funds. We have and illustration of that, too, your Honor.

THE COURT: Okay.

MR. MURRAY: The company also used a mechanism called a -- used a formula which was designed to multiply deposits on weekend periods of time. It was designed to multiply funds so that the company would obtain interest free use of bank funds over weekend periods of time and on holidays. It would multiply it times two on certain occasions, times three, or times four, depending upon the holiday period. To a certain extent some of this activity overlaps itself.

If the Court wouldn't mind, I have some illustrations, and I'll try to again be brief on the illustrations of these various fraudulent techniques. And I'll first start with -- or, for that, I'll show the Court the letter, the initial letter that started this investigation, and then show briefly some of the activity.

I can show this to the Court. I have produced for the Court a copy of the exhibits that I'm going to present to the Court.

I think, if the Court please, I would like to withdraw the first document. And the reason being, I think I've explained fully how the investigation commenced. And also I believe it was my intention not to introduce that, and I expressed that intention to defense counsel, and that was the word that I had given, and I will not go back on my word on that. So I would like to withdraw the first document that's a part of the offer, if that's okay with defense counsel?

MR. [illegible]: That it is, your Honor.

MR. MURRAY: Thank you.

Your Honor, the first document I'd like to show the Court is an analysis that was done by the investigators in this matter, and I don't know if the Court can see it, that's why I've given the Court a copy of it. I hope this is the one. For November of 1981. This is an example of the -- this was taken from the Hutton book, general ledger balances of Hutton's books. And it represents the bank account, a local bank account in the Northern Central Bank in Williamsport, Pennsylvania. And the Hutton Account Number or the bank account number is A14-1100.

If the court will see on the far left side, it's for the month of November of '81, and the column representing "Customer Receipts" is what it represents. Customer Receipts, monies received legitimately as a result of customer business.

If the Court will see, in the middle of the exhibit, you'll see "Total Receipts." And it indicates, for instance, for November 2nd, 1981, there was $92,475.12 in customer receipts, and the total receipts were $925,000.00. And the drawdown or the amount that was withdrawn from that bank that day and deposited into Manufacturers Hanover Trust Company, was $925,000.00.

If the court sees on the [illegible] column, you'll see it says, "Chemical to 12/4 United States Trust Company." Chemical is the Chemical zero balance account.

If the Court will see, what occurred on that . . .

check, which is drawn on the zero balance account, was deposited in the amount of $832,524.88, and that was deposited solely for the purposes of covering the overdraft that had been created the day before.

THE COURT: Let me ask you this. It says "Chemical To 12/4 UST from 12/5."

MR. MURRAY: Chemical Bank was used during those periods of time, and then the account was changed to United States Trust Company during those periods of time.

THE COURT: Oh.

MR. MURRAY: The entire third column, which represents all of the funds that were deposited into this bank account from Chemical Bank, et cetera, was the amount of the unauthorized loan that was taken. If the Court can see that, it is a disproportionate amount of monies, customer monies and covering checks.

The book balances, or the negative balances on the far right-hand corner, represent the amount of the overdraft total. I will show you summaries of that, your Honor.

The next exhibit is for December, relating to that same bank account, and as the Court will see, this activity continues from December 1st, 1981 to December 31st, 1981.

What differs in this exhibit, however, your Honor --

THE COURT: There is this now, do you have a copy of that for me?

MR. MURRAY: That should be the next, I hope, it should be the next exhibit on the offer of proof.

THE COURT: I'm sorry, the next one here is a duplication of the November entry.

MR. MURRAY: You've got November, and you've got November again. You have no December. Why don't you use mine, your Honor?

THE COURT: Okay.

MR. MURRAY: Your Honor, the next chart shows, again, the similar activity of the depositing of the Chemical check in excess amounts. Ranging to a high of approximately $900,000.00, based upon, in some situations, only customer receipts of $15,000.00.

But what differs in this situation is the other fraudulent scheme which the government is alleging occurred in this matter, and that is the interbranch transfers. As you can see in the third column, there are branch transfers from the A-02 branch, which is from another account located in the Atlantic region. The A represents the symbol designation for the region. It was not --

THE COURT: But it would be a branch --

MR. MURRAY: A branch account. So what we have is the injection of branch funds coming into another local branch. There's no legitimate business purpose for this type of activity in the account, other than to delay ultimately the collection of funds.

Your Honor, the next chart, I hope that the Court has, is a summary of Williamsport, Pennsylvania, Northern Central Central Bank, account A-14. And for clarification, your Honor, this runs from January, 1981, and runs through February of 1982. Although there is March and April here, the basic period of time is, it ends, and there is no further account activity during that period of time.

If the Court will see the grand totals for the entire year of 1981, through February of 1982, there was a total-- the total sum of customer money received, legitimately received by this branch was $27,218,509.87.

The total drawdown during that period of time, however, was a $129,419,150.80 odd cents.

The amount of unlawful funds injected in this account, represented by Chemical Bank and U. S. Trust Company, you will see, your Honor, is a $100,769,830.62. Approximately four times the amount of actual customer, legitimately customer money received.

THE COURT: All right.

MR. MURRAY: Your Honor, the next two charts basically are just graphic computer generated depictions of this activity occurring in November of 1981, and December of 1981.

The symbols in the top of the graph, for instance, for November, represents the overdraft, and the amount of Chemical money is represented in a square symbol, and the bottom symbol represents customer money. These two charts are just computer generated graphics.

Your Honor, the next activity in the Middle District of Pennsylvania is the activity in Wilkes-Barre, Pennsylvania, branch of United Penn Bank.

Excuse me, your Honor.

Your Honor, for the period of time of November, '81, we show again, your Honor, if the Court can see, as far as customer deposits, we can see that there was a -- for instance, on November 2nd, 1981, there was $23,325.68 legitimately received and normally received by this branch.

However, on that same day, a deposit was made in the amount of $2,476,000.00, which created an overdraft of the difference between the two. That represented, again, the unlawful scheme --

THE COURT: Let me ask you this. On November 1, there was a book balance deficit of $2,497,000.00?

MR. MURRAY: Yes, your Honor.

THE COURT: And on the following day, November 2, some $23,000.00 in customer deposits were received, and then a $2,476,000.00 check from either Chemical, or United States Trust is received to balance that, to make up that deficiency?

MR. MURRAY: That's correct.

THE COURT: Now, how would that take place? Would that be a wire transfer?

MR. MURRAY: No, your Honor, that would be an actual drawing in the Wilkes-Barre branch of a check drawn on Chemical Bank. Each of the branches throughout the system had pre-signed checks drawn on Chemical Bank.

THE COURT: On the zero balance bank?

MR. MURRAY: That's correct, your Honor.

THE COURT: Okay.

MR. MURRAY: Your Honor, the next chart, all right, I believe is the activity for December of 1981.

THE COURT: Yes.

MR. MURRAY: In the same bank account. Your Honor, again, the activity of the depositing of the United States Trust Company checks continue. What is different about this is, one, the large overdrafts that are being created, anywhere from $1,000,000.00, and it pyramids to $5,000,000.00 to $6,000,000.00 to $7,000,000.00 to $11,000,000.00 in this branch account. This is as a result, as the Court can see, the injection of not only Chemical money, and United States Trust Company money, but also interbranch transfers from A-19, the A-16 office, the A-24 office. Those offices are all located in the Atlantic region. I don't know the specific designations, and forgive me, your Honor, but they are offices located, I believe, in New York City.

So what we have is, that instead of these various offices A-19, A-16 and A-24 concentrating its money directly in New York City where the branches are located, the money is being shuttled out to Pennsylvania.

Your Honor, the next chart of the same bank account represents the totals between the period of time of January of 1981 and December of 1981. The customer monies received by the Wilkes-Barre branch, for the total of $20,208,754.22. The total drawdown, based upon those customer monies of $20,000,000.00 odd, was $137,137,140.56. The difference between the two was the interbranch transfers from A-19 of $435,000.00, from A-16 in New York of $7,200,000.00, of A-24 branch of $8,067,000.00, and A-24 of $900,000.00.

Your Honor, the balance of the charts, again, are computer generated graphics of the activity occurring in December of '81 and in November of '81.

Your Honor, the activity -- the next chart is the Genesee Country Bank in Batavia, New York. This is the initial bank that complained of the activity. This is for a period of time, basically the fraudulent activity, from December 1st, 1981, through December 11th, 1981.

I might add, Genesee Country Bank is a very small country bank. I think its assets are around $75,000,000.00, 78,000,000.00. What occurred in this bank, and this bank expected only to receive a small amount of money from that area.

since it is a very sparsely populated area, this branch, between December 1st, of '81 and December 11th, 1981, received money from the Strafford, Pennsylvania, offices in the amounts of $100,000.00, $760,000.00, $100,000.00, $1,000,000.00, $110,000.00, $500,000.00 and $1,000,000.00.

From the A-50 branch of Wilkes-Barre, Pennsylvania, of $2,500,000.00, $7,000,000.00, $2,000,000.00, $6,000,000.00, $6,000,000.00, $3,500,000.00, which created, at one point in time, an overdraft of approximately $21,000,000.00 in that small bank. This was the bank that initially complained about the activity to the banking authorities.

Your Honor, as a further explanation of this activity, I'd like to exhibit to the Court documents which were generated by the investigators involving the C-20-1100 office. The C region is the Central region of the United States, and it represents the activity in the Alexandria, Virginia, United Virginia Bank office.

Excuse me, your Honor.

For November of '81, first. The Court has that. I had the wrong one.

This is probably one of the most egregious parts of the fraud that we're charging in this matter. If the court will see, that for the period of time from November 2nd, 1981, at least that specific day, customer receipts were in the amount of $70,629.46. Based upon those legitimately received customer receipts, that branch office drewdown to Commerce Bank in Kansas City, $9,953,400.00, creating an overdraft on that day of $9,946,426.88.

As the Court can see, the next day, in order to make up the difference in the overdraft, the company, which only received $177,000.00 odd, deposited in the bank account, drawn on a zero balance account, the amount of $9,776,000.00, to cover that overdraft. Those zero balance funds were not backed up -- excuse me, should not have been deposited in that bank account. There was no legitimate business purpose.

As you can see, the activity continues throughout that month, and we have a summary chart of the activity in the Alexandria, Virginia, the United Virginia Bank for the period of time between January and December of 1981, the total amount of money received by those branches -- by that branch, the C-20 branch in customer monies, was approximately $33,537,397.20.

During that same period of time this branch office drew out of their bank account, $640,796,712.00, over half a billion dollars during this period of time, based only upon $33,000,000.00 in customer money.

In order to replace this overdraft, this branch office deposited the amount of money, illegal funds, unauthorized funds in the amount of $593,694,431.64.

THE COURT: What does the KCF mean, the column, KCM? Kansas City?

MR. MURRAY: Kansas City, Missouri.

The manager -- excuse me, I withdraw that last statement.

THE COURT: All right.

MR. MURRAY: These deposits have been acknowledged by certain employees of the company as being bogus or fictitious deposits.

Your Honor, the next exhibit is E. F. Hutton, the Fresno Office in California, Branch Number L72, branch account 1114. The L region is the Pacific South region and that's headquartered in Los Angeles.

Again, it shows the similar type activity where there are arbitrary drawdown amounts. And the amounts of funds that are drawdown every day to the region bear no relationship whatsoever to the customer monies received, and they are in the same amount, as you can see, generally, every single day.

It ranges, in the month of May, from $799,000.00, and it fluctuates between $799,000.00 and $800,000.00 a day. Based upon customer receipts much less than the drawdown amount. The difference is made up by what Hutton has deemed a branch reimbursement check, or a BRC. As the Court can see, there are substantial sums to cover the overdraft. That would represent the interest free loan of bank funds.

Your Honor, there is a summary chart on this account in Fresno, California. And that_is that during the period of time between January 1st of '81 and September of '81, there was a total amount of customer funds received in the amount of $88,518,899.51. And drawdown to the regional bank was a $135,977,000.00. There being money deposited from another zero balance account, Bank of American in California, in the amount of $24,425.83.

THE COURT: $24,000,000.00.

MR. MURRAY: $24,425,083.00, and also from Chemical Bank, starting in April of '81, in the amount of $43,505,000.00.

The balance of the charts -- the other chart, your Honor, of Fresno, California, is just a computer generated depiction.

Excuse me, your Honor.

The next exhibit, your Honor, is the banking work sheet that was utilized by the company in calculating this drawdown, which contained certain multiples.

Excuse me, your Honor.

Your Honor, may we have a second, please?

THE COURT: Did you want a recess?

MR. MURRAY: No, your Honor.

MR. CLARK: I don't believe that's necessary, your Honor.

MR. MURRAY: Your Honor, may we have a five-minute recess, please?

THE COURT: Yes, we'll have a recess now.

(11:00 a.m., Court recessed.)

(11:15 a.m., Court resumed.)

THE CLERK: Court is now in session.

MR. MURRAY: Your Honor, thank you very much for the recess. If I might continue, Your Honor?

THE COURT: Yes.

MR. MURRAY: Your Honor, the last exhibits that I tried to explain to the Court were illustrative of the excessive drawdown and arbitrary amounts and the covering of those overdrafted accounts by zero balance accounts, which is a part of the scheme to obtain unlawful bank funds, and to make interest off of those funds, which the company was not entitled to.

The next part of the activity that's charged in the Information, which the government has determined to be fraudulent, is the activity of what we call chaining, or the transfer of funds between branches, as opposed to between a branch and a region, or a branch and a prime concentration account, solely for the purposes of creating float within the banking system, and delaying the clearing time of checks through the Federal Reserve and the banking system.

If the court please, we'll have Inspector James Henerson of the Postal Inspection Service, who prepared these documents -- Henerson, H-e-n-e-r-s-o-n -- explain the various charts and also the chains that were formed in charts number.

three and four. We have additional charts in the courtroom, also descriptive of chains, chart six, chart two, chart five, but we will not be explaining those. Since they represent similar activity, it won't be necessary to explain all the charts.

THE COURT: You may proceed.

MR. KENERSON: Your Honor --

MR. MURRAY: Speak up, please.

MR. KENERSON: I'll try. Each map contains, superimposed in yellow, the outline of the appropriate Federal Reserve Districts, and the district is numbered in the little yellow disk.

The first chain on this map is titled the Genesee chain. From December 1 through December 11, 1981, White Plains, New York, the branch at White Plains, New York, and two New York City branches, were drawdown by the branch at Wilkes-Barre, Pennsylvania. Wilkes-Barre and Strafford, Pennsylvania, were, in turn, drawdown by the branch at Batavia, New York, which is Genesee Country Country Bank. Batavia was then drawdown by yet another New York City branch. This was, in turn, drawdown by the Atlantic regional account located at Rochester, New York. Rochester was then drawdown simultaneously by the regional accounts for the Midwest region located at Chicago, and the South Central region located at Dallas, Texas.

The Dallas account was then ordinarily drawdown by the concentration account at Manufactureers Hanover in New York, and the Chicago account by the West Coast concentration account at Bank of American.

MR. MURRAY: Your Honor, all this activity occurred on one day, so that these deposits were sent to successive branches, as mentioned, rather than one or two locations.

MR. KENERSON: Normally these Atlantic region branches would be drawdown directly into the concentration account at Rochester, or directly into Manufacturers Hanover prime concentration account in New York City.

The second chain shown on this map is the Las Vegas, Nevada, chain. In September of 1981 Las Vegas, which is a branch office located in the Mountain region, drewdown other branches within the Mountain region, located at Tucson and Mesa, Arizona, El Paso, Texas, Roswell and Albuquerque, New Mexico.

Las Vegas was then drawndown by the regional, the Mountain regional account at Denver, and Denver, subsequently, by the West Coast concentration account at Bank Of America.

Normally Las Vegas, and all the offices which it drewdown, would have been drawndown directly by the Denver regional account.

MR. MURRAY: So we then have a deviation, your Honor, from the normal drawdown pattern, from branch to region. Instead we have from branch to branch.

MR. KENERSON: The last chain depicted on this map is the Casper chain. This took place in November of 1981. In this particular case the branch office at Casper, Wyoming, drewdown branch offices at Boulder and Colorado Springs, near Denver. Casper was then drawndown by the regional account at Denver. And subsequently Denver by the West Coast account at Bank Of America.

Normally the Denver regional account would have drawndown directly to Casper, Boulder and Colorado Springs, as well as the other offices in the Mountain region.

Excuse me.

On map number four, the first chain we have is the Saint Louis, Bethesda, Seattle, Washington. This occurred in the period of time between October, 1981 and January, 1982. The Central region branch office at Saint Louis, Missouri, was drawndown by the branch at Bethesda, Maryland, also located in the Central region. Bethesda was then drawndown by the branch at Seattle, Washington, which is located in the Pacific North region, and then Seattle by the West Coast concentration account at Bank Of America.

Normally, both Saint Louis and Bethesda, located in the Central region, would have been drawndown by the regional concentration account for the Central region at Kansas City, Missouri.

MR. MURRAY: Maybe quickly, your Honor, just to show one particular point in this Seattle/Bethesda chain.

Ge erally it would take one day to clear a check that was de osited in Seattle, and that was concentrated in San Fr ncisco. So there would be one day clearing here.

What occurred, by sending Maryland money and de ositing it in Seattle, this bank here in Seattle was not able to collect the funds in this account on a timely basis, because it would take two days to clear that money back. So as this dr ndown check pulled the funds out of the Seattle office, on da one, this bank here would be uncollected, because it would ta two days to clear this deposit back to Bethesda.

THE COURT: I understand.

MR. KENERSON: The next chain we call the Hu ington chain. The Atlantic region branches at Philadelphia, Ch ry Hill, New Jersey, Newark, New Jersey, and Wyomissing, Pe sylvania, were drawndown by the branch at Huntington, West Vi nia, also located in the Atlantic region. Huntington was th drawndown by the regional account for the the Northeast re n located at Boston, and then Boston by the prime account at w York City.

Normally all these branches, Huntington, Wy issing, Newark, Philadelphia, Cherry Hill should have been d wndown directly by the Atlantic regional account at R hester, New York, or by the prime account at New York City.

The next are F region chains, which took place in ptember of 1981. The branches at Southfield, Michigan, in

Minneapolis, Minnesota, both in the Midwest region, were drawndown by the South Central region, regional account at Dallas, Texas. Dallas would normally have been drawndown by the New York City prime account.

Also in September, Southfield was drawndown by the branch at Milwaukee, Wisconsin, and Milwaukee and Minneapolis were drawndown by the branch at Grand Rapids, Michigan, which was Old Kent Bank. Old Kent was then drawndown by the Midwest region concentration account at Chicago, which subsequently would be drawndown by the Bank Of America. Normally these Midwest region branches would have been drawndown directly into the Chicago account.

THE COURT: What delay difference would that make?

MR. MURRAY: It would, because of the fact that the covering check, the Chemical check to go into cover the overdraft would take a longer period of time to clear. It would take an extra day to clear.

THE COURT: A day.

MR. MURRAY: Sometimes more, but generally a day.

MR. KENERSON: The fourth chain on this map is the El Paso chain, which was in effect during August and September of 1981. The branches, or the branch at El Paso, Texas, located in the Mountain region, drewdown the branches at Masa and Tucson, Arizona, Las Vegas, Nevada, Albuquerque and Roswell, New Mexico. El Paso was then drawndown by the regional account at

Denver, which was subsequently drawndown by Bank of America on the West Coast. Normally all of these branches would have been drawndown directly into Denver.

The next chain is the Clearwater to Denver chain. Clearwater, Florida, which is located in the Southeast region, and subsequently by its successor branch at Madeira Beach, Florida, was drawndown by the Mountain region account at Denver; Denver subsequently by Bank of America. Normally Clearwater and all Florida branches would have been drawndown by the regional account at Atlanta, subsequently into New York.

The last chain on this map is the Miami/Dallas/Atlanta chain. This occurred throughout 1981. The branch at Miami, Florida, located in the Southeast region, was drawndown usually on an alternating basis by the regional account at Atlanta, and the South Central regional account at Dallas, subsequently into New York.

It is interesting that another Florida branch, which we just explained, Clearwater, was drawndown by Denver, and the nearby branch at Miami Beach was drawndown by Boston.

As I said before, all Florida branches normally would have been drawndown directly into the regional account at Atlanta. And on the remaining three maps there are approximately sixteen additional chains.

THE COURT: The same or similar?

MR MURRAY: Same type of activity. I might indicate, your Honor, that these various charts are illustrative of the activity that is charged in the Information. And that the defense has not had a previous opportunity to review those. But that the activity of chaining, the activity of excessive drawdowns is depicted on these maps, and taken from the government's evidence if it were to present its case before a jury to prove the charges beyond a reasonable doubt, your Honor. That is the end of our presentation on the chains and the fraudulent activity.

The Court had asked the government to review the plea bargain agreement, and I believe the Court had also asked the government as to why, if I haven't forgotten anything, why individuals in this matter have not been charged.

THE COURT: Right.

MR. MURRAY: And what I want to do is probably, even though it may be out of order, give you that information as to the individuals, and then review the plea agreement, if the Court wouldn't mind.

Your Honor, this matter presents very novel issues in many, many aspects. The agreement that has been entered into between the parties is one that has been negotiated over the past, at least intensively, over the past year between the company and their counsel, between our office, the United States Attorney's Office in the Middle District of Pennsylvania, and the Department of Justice.

THE COURT: May I ask, what other agencies, governmental agencies may have been affected, and may have been consulted?

MR. MURRAY: Your Honor, the Federal Reserve Bank of New York was affected and did a study, and a report, along with the New York State Banking Department, which determined that this activity was of a fraudulent nature and was for the purpose of creating float.

The FDIC, Federal Deposit Insurance Corporation also conducted an investigation and reached similar conclusions. Various non-governmental agencies, various banking institutions also did internal audits and determined that this activity of chaining and excessive drawdowns represented activity that was not a part of legitimate business practices and did not represent their expectations, did not meet their expectations in the handling of this account.

A team of, what we believe to be experts of the United States Postal Inspection Service, accountants, several accountants, reviewed the activity and reached that conclusion. So it's been reviewed by many, many persons, your Honor.

THE COURT: Okay.

MR. MURRAY: Maybe I misconstrued the Court's question. Was the Court questioning me as to the plea agreement or as to --

THE COURT: Yes, as to the plea agreement.

MR. MURRAY: Oh, as to the plea agreement, review it by the government. The plea agreement --

THE COURT: I thought I'd get back to you.

MR. MURRAY: The plea agreement was negotiated by, mainly by the Department of Justice, the Criminal Fraud Division, since they are supervising the case, and by Mr. Robert Ogren, personally, along with Mr. Clark, myself, and I think it's also been signed by and reviewed by the Assistant Attorney General, Stephen Trott. These negotiations lasted over approximately four months, with the department, and Mr. Curnin and I and other defense counsel, I believe, commenced negotiations sometime in April of 1984.

THE COURT: I suppose what I'm asking, would the Federal Reserve Board, or counsel for the Federal Reserve Board be kept abreast of plea bargain discussions?

MR. MURRAY: No, your Honor.

THE COURT: All right.

MR. MURRAY: The Federal Reserve has, however, in its policies and in its report of April of 1982, viewed these policies as being unlawful, or these practices, sorry, your Honor, as being unlawful.

Your Honor, we believe that the plea bargain agreement, which calls for a plea of guilty to 2,000 counts, and, I believe, I've been told by the Department of Justice that this is probably the largest, numerically, type of Information, or even indictment, filed. That it's of a comprehensive nature. It covers a situation where a $2,000,000.00 fine will be paid, the maximum penalty on the law. It requires a $750,000.00 fine be paid, in order that the government's costs and expenses will be fully recouped.

THE COURT: $750,000.00 --

MR. MURRAY: Excuse me?

THE COURT: -- reimbursement?

MR. MURRAY: $750,000.00 reimbursement for cost of prosecution. Of investigation, rather, your Honor. Not prosecution, investigation.

The civil action in this matter contains within it an injunctive action, which prevents certain practices, such as these, and excessive drawdowns, which we've tried to illustrate for the Court. This has an immediate impact and affect upon the banking industry.

During the course of the investigation, it's a possibility, or we believe that maybe other large corporations are engaged in this type of activity. We believe the fact that E. F. Hutton will admit their guilt to this activity, and agree to be enjoined, and to stop these practices is of major importance. And we believe that a trial of this matter, which would take approximately, we anticipated a year to two years, possibly, because of the complexity of the case, would allow possibly this activity continue during the course of this trial.

What it does, the injunctions, it requires the company to disclose to banking institutions the concentration practices, the money management practices that are being utilized for the transfer of monies between banking institutions. That is novel and new, never been done before. It requires that there be written agreements or consents by the banking depository that's affected by the account, Hutton maintained the account, to enter into these agreements in the event that the company was to draw against uncollected funds.

It prevents the company from drawing Hutton to Hutton checks, or checks drawn on itself. It provides for prophylactic measures, as far as instructional seminars to all Hutton employees in regard to these practices. It calls for the auditors of the company to revise their procedures for all affiliates, wholly owned affiliates, I believe, subsidiaries, et cetera.

It is an immediate remedy, as opposed to a long-term one, which we consider to be in the interest of the United States, to be paramount at this point in time. I believe it aids the banks in its ability to detect these type of money management practices, especially in the cash money management, and the area is new, is relatively new.

I almost forgot the most important provision, and that's restitution. Restitution is probably the most important provision, other than the wherefor clauses and the injunctions.

The restitution provision is a wide-open one. It provides restitution for all banks that Hutton maintained a depository relationship with during the period of time between July 1st, 1980 and December 31st, 1982. That period extends beyond the information period of time.

It s a wide open restitution agreement, in that Hutton will pay whatever claims the banks can legitimately establish for any net uncompensated losses sustained. And that would be losses from these practices of drawing against uncollected funds, and in creating these excessive drawdowns. Losses for services and also interest.

It provides that notice, adequate notice to all of the various banks that are affected, and there are approximately 400 banks that will be affected by this action, major banks. And it provides a very fair and equitable formula for the determination of these losses. Tha , we believe, is an immediate remedy, which is very important and probably never has been done before.

Your Honor, one other point which I think is important, is that the corporation benefitted from this activity. The system, while it's a very unique and very complex type of a system, was designed to benefit the corporation. The persons, or personnel that designed the system, basically, did not benefit from it, nor did senior management necessarily directly benefit from this activity. It was designed to benefit the corporation.

And as the corporation was set up, and this would be the government's evidence, it's divided into the nine regions, which are similar to being nine separate corporations, each headed up by individuals. The basic overall policy of the corporation was set by senior manager. The implementation of that is done basically almost on an autonomous basis by the regions, even though there is supervision.

The actual persons that benefitted, it would be the corporation as a whole, as opposed to any one, necessarily, individual, and the system was designed so to be. I would think that the government would defend this plea agreement to the nth degree as being very, very fair. Not only to the defendants, but also to the interests of the United States.

I don't believe that in a lengthy trial of this matter, and the uncertainty of a trial, and even the end result of a trial, we would get the relief, the immediate relief for the banking system, and a message to the other corporations throughout the country that these type of practices will not be tolerated. That we wouldn't get that type of relief if we did go through a long lengthy trial.

THE COURT: You mean lengthy trial including individual indictments?

MR. MURRAY: Yes, your honor, that's correct. We think that this agreement is fair; that it's one that has been worked on extensively; and I think there are no bugs in this agreement; it provides for immediate relief to the banks, and affected potential victim banks of this; it requires a shoring up of the banks and cash management procedures; and it's eminently fair to all parties involved.

THE COURT: Are you aware of any internal action by Hutton against those who may have initiated, originated or participated in the planning of the scheme?

MR. MURRAY: Your Honor, I don't know if I'm really qualified to answer that question.

THE COURT: All right. I just asked you if you knew.

MR. MURRAY: Okay.

THE COURT: If you don't, okay.

MR. MURRAY: I believe, also, this matter's been reviewed by the Department of Justice, and its an unprecedented case.

THE COURT: As I asked you in Chambers, if you will forgive me, Mr. Ogren is a career Justice Department Official, am I correct in that?

MR. OGREN: Far too much career sometimes, your Honor. I've been there for close to 20 years, in one fashion or another. I'm a former Assistant U. S. Attorney for the District of Columbia.

I might just add that I concur completely in Mr.

Murray's remarks. Of course, as your Honor I'm sure is aware, it is our policy to prosecute individuals where there is appropriate level of responsibility. And it takes what we regard as exceptional benefits, in the interest of law enforcement and in protecting the citizens of the United States, that leads us to a conclusion that under the circumstances here, the result, the injunctive proceeding, the heavy fine, very favorable for the victims restitution provisions, which further the principals under the Victim and Witness Protection Act, that all of that is a package that is very attractive, indeed, from the point of view of law enforcement, and it does provide immediate certainty. We're very pleased with it.

THE COURT: All right, thank you.

Do you have anything else you want to add?

MR. MURRAY: No, your Honor.

THE COURT: All right, would defense counsel and Mr. Pierce then step forward?

I'll address the plea agreement first. Mr. Pierce, have you read the information, the government's civil complaint for a permanent injunction and the other documents, including the plea agreement?

MR. PIERCE: I have, your Honor.

MR. MURRAY: Excuse me, your Honor. At this time we'd like to offer the counts that relate to the Information. They're in a computer printout relating to the mail fraud.

THE COURT: And on behalf of the corporation can you represent to the Court that you fully understand the provisions of all these documents, including the plea agreement?

MR. PIERCE: I can, your Honor.

THE COURT: All right. And you have executed it on behalf of the corporation?

MR. PIERCE: Yes, sir.

THE COURT: All right. Now, has anyone made any promise, representation, agreement or understanding with you, or with the defendant, other than what is contained in the written plea agreement?

MR. PIERCE: No, sir.

THE COURT: Has anyone made any out-of-Court promise, representation, agreement or understanding which would require you, on behalf of the corporation, to respond untruthfully to my questions concerning the plea agreement?

MR. PIERCE: No, sir.

THE COURT: And do you understand that you may not, at a later time, contend that any promise, representation, agreement or understanding was made to the corporate defendant, and to you, by any person, other than that as set forth in the written plea agreement?

MR. PIERCE: I do.

THE COURT: All right. And do you still desire to plead guilty to the counts contained in the Information?

MR. PIERCE: Yes, sir.

THE COURT: All right. Do you or your counsel care to make any comment concerning the presentation of Mr. Murray?

MR. CURRIN: If I may, your Honor. As the Court is aware, the parties have executed a plea agreement, which is before your Honor for review and approval, and we join with the government in urging the Court to approve the plea agreement, pursuant to Rule 11(e)(1)(C) of the Federal Rules of Civil Procedure.

I note, your Honor, that the government's fact statement, which we heard today for the first time, we were not told and were not apprised of what the government would say in regard to the nature of this case, or the scope of the case, is just a statement of what the prosecution contends it would prove if this case were actually tried.

We have not had access to the testimony before the Grand Jury, and we are in no position to try to refute the statements of the prosecutor fact by fact or line by line. This is what a trial is all about; that's what a trial would establish; and hopefully there will be no plea here because of the joint -- no trial here because of the joint request that the plea agreement be accepted by the Court.

However, it is important to note that the company is charged with only two specific criminal acts here, and that is the excessive drawdowns and the multiple transfers, and for a stated period of time, ending in February of 1982.

As to these activities, however, the company admits that regretably they occurred, and widespread enough to warrant the pleas which will be offered here today by the company, as against the specific charges which appear in the Information.

When the investigation started, and as a result of the negotiations that we have had with the Department of Justice, both its representative here and in Washington, D.C, we, the company that is, evaluated what was in the best interest of the banks that dealt with the company, and also what was in the best interest of the company's shareholders.

The company determined that what would be in their best interest would not be to go to a long trial, such as Mr. Murray has referred to, but to resolve the matter now. And to do it in a way which we believe would be fair and equitable to each of the banks that dealt with us during this relevant time period. And that is why we have agreed, indeed, why we have promoted a restitution program, your Honor, which, by its terms, will fully compensate the banks who have a claim, and will do so under a very expedited program.

I would note, your Honor, that the company here is not being charged in any way, nor do any of the charges here relate to the management of customer funds or the trading in securities.

MR. MURRAY: That's correct, your Honor.

MR. CURNIN: One final point, your Honor. During the course of the government's offer of proof on the charges, and the explanation of the charges, the Court was shown various charts, which purported to depict the two specific acts charged. To Wit: Excessive drawdowns and multiple transfers.

We at no time, your Honor, had seen those charts before this morning. We are in no position, therefore, to comment on the accuracy of the factual presentation which appears in those charts. That does not mean, and it is not intended in any way to lessen the company's plea to the charges which appears in the Information.

I just wish the Court and the record to know that never having seen this material before, I am not now in any position to comment on those charts and the facts that they depict.

Also, your Honor, there was some reference to other reports or investigations. Neither of which, none of which we have ever seen at any time.

And there was also a reference to the fact that 400 banks were affected. During the period in question, your Honor, we dealt with approximately 400 banks. We do not know that each and every one of those banks were impacted by this activity. However, the restitution program will answer all of those questions.

For all of these reasons, your Honor, we join in the government's request that the Court accept the plea agreement that is before the Court for its review and approval.

THE COURT: All right. Well, do you care to make any comment?

MR. MURRAY: We'd just like to note for the record that the plea that is being entered is to the Information, and the actual objects of the scheme, and the methods and manners of effecting the scheme, and that plea will be guilty to the actual facts as alleged in the Information, is that correct?

MR. CURNIN: Yes.

THE COURT: That's about what I was just going to cover. You realize that I'm required to determine whether there is a true basis in fact for the plea of guilty to the 2,000 counts contained in the Information.

MR. CURNIN: I understand that, your Honor.

THE COURT: And rather than go over them line by line, I asked Mr. Murray if he would summarize for me, not the details, but let's say the modus operandi, so that I could be satisfied that the plea was a valid one.

And the bottom line here is, does the corporation, notwithstand the fact that it was just confronted today with the actual charts, has the corporation had a sufficient opportunity to review the 2,000 counts, and can Mr. Pierce, on behalf of the corporation, represent to me that the corporation is guilty of the 2,000 counts as contained in the Information?

MR. CURNIN: That is correct, your Honor.

THE COURT: Is that so, Mr. Pierce?

MR. PIERCE: Yes, your Honor.

THE COURT: All right. Now --

MR. MURRAY: Your Honor, I have a plea form.

THE COURT: Yes.

MR. MURRAY: If the Court will accept the --

THE COURT: I was going to explain something further that I brought up before we came in here. And that is, a defendant is entitled to a pre-sentence investigation, unless it's specifically waived or the Court believes it's not necessary.

MR. CURNIN: Your Honor, I would hand up, at this point in time, a statement, signed by the company, by Mr. Scott Pierce, and by myself and Mr. Hundley, as counsel for the company, waiving such pre-sentencing report.

THE COURT: Let me see it.

MR. MURRAY: Your Honor, it also should state, E. F. Hutton and Company. It should be spelled out on the typewritten portion. It's spelled, "Co." It should be "Company," probably.

THE COURT: All right.

The Court will accept the plea agreement, and then proceed to enter the plea.

MR. MURRAY: Okay. You've got to execute this today.

(Mr. Curnin and Mr. Pierce signed document.)

MR. MURRAY: Your Honor, the -- excuse me, your Honor.

THE COURT: Go ahead.

MR. MURRAY: Your Honor, Mr. Pierce would like to make a statement prior to the entry of the plea.

THE COURT: Pardon me?

MR. MURRAY: I think Mr. Pierce would like to make a statement prior to the entry.

THE COURT: Prior to the entry of the plea?

MR. CURNIN: Yes, your Honor, if we may.

THE COURT: Sure.

MR. PIERCE: Your Honor, the company most regrets this episode and asks the Court to approve the plea agreement, as it signals the conclusion of and unfortunate period in our history that ended more than three years ago.

The company believes that it has acted responsibly since that time. And with the taking of this plea, and the entry of the civil injunction, believes that it has taken appropriate action to compensate any banks that were injured by the company's conduct.

MR. MURRAY: Your Honor, the plea reads as follows: "And now this 2nd day of May, 1985, the within named Defendant, E. F. Hutton and Company, Inc., having been arraigned in open

Court, hereby pleads guilty to the within Information."

It is executed by Scott Pierce, as President, on behalf of the corporation.

THE COURT: Let me see it.

MR. MURRAY: Your Honor, the government would move for sentencing, and also we would hand up to the Court the final judgment of permanent injunction, against the E. F. Hutton Group, Inc., the parent, and the E. F. Hutton and Company, Inc.

THE COURT: All right. Under the rules, before the actual sentence is imposed, counsel is given the opportunity, defense counsel, to make any statement, any additional statement. And Mr. Pierce, on behalf of the corporation, will also be given any additional time he may desire, to make a statement.

MR. CURNIN: We have no additional statements to make, your Honor.

THE COURT: All right. Is that true with you, too, Mr. Pierce?

MR. PIERCE: Yes.

THE COURT: All right.

MR. MURRAY: Neither does the government, your Honor.

THE COURT: Well, the Court recognizes that the determination to proceed by this particular Information was a prosecutorial decision. And that under the circumstances the

Court is being presented with a plea agreement that allows the Court to impose the maximum sentence under each count, which would be a fine of $1,000.00.

The fraud is obviously shocking and reprehensible. But I understand the great consideration given to this matter by governmental officials and their extensive familiarity with the factual and legal background, and knowing that it has been considered by high, if not the highest level, or close to the highest level of the Justice Department, I will respect the decision to proceed only against the corporation and not against any individuals.

And I also appreciate and accept Mr. Ogren -- is it Ogren, I'm sorry?

MR. MURRAY: Ogren.

MR. CLARK: Yes, it is, your Honor.

THE COURT: Mr. Ogren's explanation, as well as yours, Mr. Murray.

And, consequently, pursuant to the provisions of Rule 11(e)(1)(C) of the Federal Rules of Criminal Procedure, E. F. Hutton and Company, Inc., will and is hereby sentenced to pay a criminal fine in the amount of $2,000,000.00, for violations of Title 18, United States Code, Sections 1341 and 1343, as alleged in the Information, and as in counts one through 2,000 thereof.

And, also, pay to the United States an additional

$750,000.00, as compensation to the United States for the costs of investigation.

MR. MURRAY: Investigation. That will be distributed between the United States Postal Inspection Service and the United States Attorney's Office for the Middle District of Pennsylvania.

THE COURT: Now, in the proposed agreement it provides that it shall be paid within five days after the entry of the final judgment.

MR. MURRAY: That's correct, your Honor.

THE COURT: Consequently, again, the total of said criminal penalty and costs of prosecution shall be in the amount of $2,750,000.00, and such amount shall be paid in full within five days after the entry of final judgment hereon.

I should state for the record that the copies of these documents were supplied to me on Tuesday. The documents being the proposed Information, the proposed notice of plea agreement, and the plea agreement, the application or complaint for permanent injunction and ancillary relief, the consent and undertaking of the E. F. Hutton Group, Inc., and E. F. Hutton and Company, Inc., and the final judgment of permanent injunction against the E. F. Hutton Group, Inc., and E. F. Hutton and Company, Inc.

So I've had a more than adequate opportunity to review the documents. And as the transcripts of the records that will be filed will show, I've had, in addition to the explanation in open court, a rather thorough explication of the government's theory, the factual background, and of the documents that were presented to me for consideration.

I'll make two corrections on the orders. It has Harrisburg, Pennsylvania, on here.

MR. MURRAY: That's correct. It should be Scranton, your Honor.

THE COURT: So today being May 2nd, and the locale being Scranton, Pennsylvania, I, at this time, have signed the final judgment for permanent injunction.

Do you want the copies signed, too?

MR. MURRAY: If you would, please, your Honor.

THE COURT: Sure. Is there anything else?

MR. CLARK: No, your Honor.

THE COURT: Anything else?

MR. CURRIN: Nothing further, your Honor.

MR. MURRAY: Nothing further, your Honor, thank you very much.

THE COURT: All right. Thank you, we're adjourned.

THE CLERK: Court is now adjourned.

(Record is closed.)

CERTIFICATE

I hereby certify that the proceedings are contained fully and accurately in the stenographic notes taken by me during the hearing of this matter, and that this copy is a true and correct transcript of my said notes.

Official Court Reporter

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

THE E.F. HUTTON GROUP INC.,
E.F. HUTTON & COMPANY INC.

Defendants.

CIVIL ACTION NO. 85-

COMPLAINT FOR PERMANENT INJUNCTION AND ANCILLARY RELIEF

Plaintiff, the United States of America, for its complaint herein alleges as follows:

1. Defendants are The E.F. Hutton Group Inc. ("Hutton Group") and E.F. Hutton & Company Inc. ("Hutton Company"). Hutton Company was in the past engaged in acts and practices which constitute violations of Sections 1341 and 1343 of Title 18 of the United States Code, and defendants may be or are about to engage in practices which constitute violations of Section 1344 of Title 18 of the United States Code.

2. The plaintiff brings this action to enjoin such acts and practices pursuant to Section 1345 of Title 18 of the United States Code.

3. The Court has jurisdiction of this action pursuant to Section 1345 of Title 18 of the United States Code.

4. The defendants could and/or are about to, unless restrained and enjoined, engage in the acts and practices set forth in this Complaint and in acts and practices of similar purport and object.

5. The acts and practices constituting the violations herein have occurred and may occur within the jurisdiction of the United States District Court for the Middle District of Pennsylvania and elsewhere.

6. The defendants, directly and indirectly, made use of the United States mail, wire communications and facilities and instrumentalities of interstate transportation and commerce in connection with the acts and practices alleged herein, in the Middle District of Pennsylvania and elsewhere.

THE DEFENDANTS

7. Defendant The E.F. Hutton Group Inc. ("Hutton Group"), a Delaware corporation, maintains its principal offices at One Battery Park Plaza, New York, New York. Hutton Group is a publicly held corporation, and its stock is registered with the Securities and Exchange Commission pursuant to Section 12 of the Securities Exchange Act of 1934 [15 U.S.C. §78l]. Hutton Group is the parent of the defendant E.F. Hutton & Company Inc.

8. Defendant E.F. Hutton & Company Inc. ("Hutton Company"), a Delaware corporation and a wholly owned subsidiary of the defendant Hutton Group, maintains its principal offices at One Battery Park Plaza, New York, New York and regional and branch offices throughout the United States. It is one of the nation's largest broker-dealers of securities and is registered with the Securities and Exchange Commission pursuant to Section 15 of the Securities Exchange Act of 1934 [15 U.S.C. §78o].

INTRODUCTION

9. At all times material herein, the defendant Hutton Company was organized into nine domestic operating regions and one international operating region. These regions were:

Northeast Region in Boston, Massachusetts
Atlantic Region in New York, New York
Southeast Region in Atlanta, Georgia
Midwest Region in Chicago, Illinois
Central Region in Kansas City, Missouri
South Central Region in Houston, Texas
Mountain Region in Denver, Colorado
Pacific North Region in San Francisco, California
Pacific South Region in Los Angeles, California
International Region in Geneva, Switzerland

Each of these regions was supervised by a regional vice-president who reported directly to Hutton Company's president. In each of its domestic operating regions, the defendant Hutton Company maintained branch offices supervised by branch office managers. Regional and branch offices of the defendant Hutton Company also employed operations managers and cashiers who performed "back office" functions of the defendant's business. These regional and branch office operations managers and cashiers reported directly to their immediate supervisors, the regional vice-presidents and the branch office managers, and indirectly to defendant Hutton Company's operations managers in New York City.

10. At all times material herein, the defendant Hutton Company received from its individual and institutional customers, in the course of its business, between $40 million and $200 million each business day at its more than 300 branch offices located throughout the United States. Funds received from said customers were ordinarily first deposited in various local

depository accounts maintained by the defendant Hutton Company in approximately 400 banks and financial institutions located throughout the United States.

11. As used herein, the terms "depository bank" and "depository account" shall mean the bank or account to which any instrument for the payment of money is transferred for collection. In many cases, as more fully set forth below, the defendant Hutton Company's stated purpose in having is branches open such accounts at depository banks was to use these accounts for the collection and concentration of funds received from its customers, and it was the expectation of these depository banks that such accounts would be so used.

12. At all times material herein, Hutton Company instituted and maintained a domestic "cash concentration" system, the legitimate purpose of which was to collect funds received from the defendant Hutton Company's individual and institutional customers, to transfer those funds to regional depository bank accounts and thereafter to transfer those deposits to certain prime depository bank accounts maintained in New York City and Los Angeles, California.

13. In general terms, this system, which was also known as the "drawdown system", operated as follows:

(a) Hutton Company branch office cashiers were instructed to calculate, on a daily basis, the net activity in their branch office's depository bank accounts and to transmit that information to their regional office cashiers. The regional offices maintained checks for each of the branch office depository accounts located in their regions, and the defendant Hutton Company's regional office personnel would thereafter prepare "depository transfer checks", or "DTC's", drawn upon each branch office depository account, and deposit these DTC's into the appropriate regional office depository bank accounts.

(b) following the process described in subparagraph "(a)" above, the regional offices of the defendant Hutton Company would telephone its "Cash Desk" in New York City and report the aggregate net activity in the various regional depository bank accounts (which net activity included, as its primary component, the DTC's described above). Promptly thereafter, the Cash Desk would prepare DTC's drawn upon the regional depository bank accounts of the defendant Hutton Company's South Central, Southeast, Northeast and Atlantic regions and manually deposit those items into an account maintained at Manufacturers Hanover Trust Company, the defendant's prime concentration bank in New York City. Information as to the amount of funds deposited into the defendant Hutton Company's regional depository bank accounts for its Pacific North, Pacific South, Mountain, Central and Midwest regions, was telexed by the Cash Desk in New

York City to Bank of America, the defendant's prime concentration bank in Los Angeles, California. Bank of America, acting as agent for the defendant Hutton Company, immediately prepared DTC's drawn upon the aforesaid regional depository accounts for collection into the defendant's concentration account.

(c) At various times material herein, the defendant Hutton Company's regional and branch office operations managers and cashiers were instructed to calculate the amount of funds to be drawn down from their respective depository banks by using various forms known as "Drawdown Sheets", many of which required the aforesaid managers and cashiers to ascertain their depository bank's "ledger or book balance", rather than the bank's "available balance." By using a bank's ledger balance to calculate the amount which would be drawn down from branch and regional depository banks, the defendant Hutton Company sought to obtain the use of funds representing not only the amount of its deposited customers' funds which had cleared but also funds in the process of collection. In addition to the foregoing, the computations required to be made using the Drawdown Sheets provided that on certain days of the week a "multiplier" would take effect increasing, by a factor of two, three or four, certain portions of the amount to be drawn down from a branch or regional depository bank.

(d) at various times material herein, the defendant Hutton Company maintained "zero balance" accounts at United States Trust Company of New York and Chemical Bank in New York City and Bank of America in Los Angeles. By arrangement with these banks, the defendant Hutton Company was permitted to draw checks upon these accounts -- in which the defendant Hutton Company was required to keep no balance -- with the understanding that it would, on a daily basis, wire transfer into these accounts sufficient funds to cover all checks presented against the accounts for payment. When these zero balance accounts were established, their stated purpose was that they would be used to cover clerical errors and returned customers checks, and the banks reasonably expected that the accounts would be used for these purposes.

SCHEME TO DEFRAUD

14. Beginning on or about July 1, 1980 and continuing through February 28, 1982, in the Middle District of Pennsylvania and elsewhere, the defendant Hutton Company devised and intended to devise a scheme and artifice to defraud and obtain money from various banks and financial institutions with which the defendant Hutton Company had established depository relationships as more fully set forth below.

OBJECT OF THE SCHEME

15. The object of the scheme and artifice to defraud was to obtain interest free funds by means of the intentional overdrafting of various of Hutton Company's depository bank accounts, in the manner and means more fully described herein.

MANNER AND MEANS OF EFFECTING
THE SCHEME AND ARTIFICE TO DEFRAUD

16. It was part of said scheme and artifice to defraud that the defendant Hutton Company would and did fraudulently misuse its depository bank accounts, for the purpose of obtaining the interest-free use of bank funds, by manipulating the check collection system and procedures of the Federal Reserve System and causing repeated and substantial drawings against uncollected funds. This scheme and artifice to defraud, all in violation of Sections 1341 and 1343 of Title 18 of the United States Code, was accomplished by, among other things:

(a) drawing down arbitrary amounts unrelated to and in excess of the volume of customer funds deposited, and thereafter covering such excessive drawdowns by depositing checks drawn upon zero balance accounts of the defendant Hutton Company; and

(b) causing funds to be successively transferred between various branch and regional depository bank accounts of the defendant Hutton Company, prior to their deposit in a prime depository bank, thereby inflating the funds drawn down so that they exceeded the amount of customer funds originally deposited; and (i) utilizing in conjunction therewith formulas and methods by which the actual amount of customer funds was excessively multiplied or otherwise arbitrarily increased and (ii) exploiting the opportunities for delayed clearing times of items deposited into the defendant's branch and regional depository banks.

During the period from July 1, 1980 through February 28, 1982, the defendant Hutton Company's drawings against uncollected funds aggregated well in excess of $1 billion.

DRAFTING OF CHECKS IN EXCESS OF HUTTON COMPANY BOOK BALANCES

17. As a further part of the conduct described in paragraphs "14" and "16" above, and from on or about July 1, 1980 through February 28, 1982 the defendant Hutton Company, in the Middle District of Pennsylvania and elsewhere, knowingly executed and attempted to execute various modifications in the cash concentration or drawdown system for the purpose of facilitating the drafting, issuance and negotiation of checks drawn upon the defendant Hutton Company's branch depository accounts, which checks were arbitrary and unrelated to the amounts of Hutton's customer deposits.

18. As a further part of the conduct described in paragraphs "14" and "16" above, and from on or about July 1, 1980 to on or about February 28, 1982, the defendant Hutton Company, in the

READEX FICHE

Middle District of Pennsylvania and elsewhere, knowingly executed and attempted to execute various modifications in the cash concentration or drawdown system for the purpose of artificially inflating the interest benefit to be derived therefrom. Defendant Hutton Company provided financial inducements and incentives to its branch office managers that, among other things, encouraged them to be more "aggressive" and "creative" in the overdrafting of their bank depository bank accounts. The financial inducements and incentives included crediting the branch offices with any interest benefits inuring to defendant Hutton Company arising out of the branch's relationship to its depository banks. In general, ten percent of the branch profits (which included interest charges and credits) were paid to the defendant Hutton Company's branch office managers as part of their compensation. Stimulated by the aforesaid inducements, and realizing that they could not employ the formulations of Hutton Company's Drawdown Sheet either "aggressively" or "creatively" without disregarding the formulations of the drawdown sheets, certain of defendant Hutton Company's branch office managers resorted to the only other available method for increasing the amounts drawn down from the branch depository banks -- the withdrawal of wholly arbitrary and excessive amounts. For example, some branch office personnel using the draw down formulation, arrived at a final figure for withdrawal and then added a "zero", thereby increasing the amount of the withdrawal ten-fold. Others disregarded the Drawdown Sheets altogether, and withdrew arbitrary and excessive amounts.

CHAINING OF BRANCH AND REGIONAL DEPOSITS

19. As a further part of the conduct described in paragraphs "14" and "16" above, and from on or about May 1981 through February 1982, the defendant Hutton Company, in the Middle District of Pennsylvania and elsewhere, did further modify its stated cash concentration or drawdown system by causing various of its branch and regional offices to transfer, laterally or horizontally, from one branch depository bank or regional depository bank to another, funds withdrawn from various original depository banks. These horizontal or lateral drawdowns, or "chains", required the simultaneous, coördinated efforts of as many as 10 branch and regional offices of the defendant Hutton Company, in the communication of information and preparation of drawdown DTC's, to accomplish the transfer of "funds" from the original depository banks to the defendant's prime concentration banks. This increased the total dollar volume of drawdown checks in the system and thereby increased the potential interest benefit to the defendant Hutton Company, as hereinabove alleged, by increasing the opportunity for delayed clearing.

WHEREFORE, plaintiff, the United States of America, respectfully prays and demands:

1. An order restraining and enjoining the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., their officers, agents, employees, directors, successors, assigns, and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from use of the mails or wires, or means

and instrumentalities of interstate commerce for employing any device, scheme or artifice to obtain for Hutton Company and Hutton Group any money, funds, credits or assets, owned by or under the custody or control of a federally chartered or insured financial institution by means of false or fraudulent pretenses, representations or promises.

2. An order directing the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. to disclose and describe, in writing, to each bank or financial institution with which they maintain a depository account, all money management practices or techniques which may affect, directly or indirectly, the use of such account in connection with the concentration of funds, including, without limitation, intra-company transfers of funds into and out of such account.

3. An order restraining and enjoining the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., their officers, agents, employees, directors, successors, assigns, and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from drawing down, from any Hutton account at a depository bank, arbitrary amounts by means of overdraft checks unrelated to the volume of customer funds deposited, and thereafter covering such drawdowns by checks drawn upon another of Hutton's accounts.

4. An order restraining and enjoining the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., their officers, agents, employees, directors, successors, assigns, and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from causing funds to be successively transferred between Hutton's various branch and regional bank accounts, prior to their deposit in a prime depository bank, in order to inflate the funds drawn down so that they exceeded the amount of customer funds originally deposited; and (i) utilizing in conjunction therewith formulas and methods by which the actual amount of customer funds are excessively multiplied or otherwise arbitrarily increased and (ii) thereby exploiting the opportunities for delayed clearing times of items deposited into the defendants' branch depository banks.

5. An order restraining and enjoining the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., their officers, agents, employees, directors, successors, assigns, and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from causing uncollected funds to be withdrawn by any means, including the use of a multiplier or formula, from Hutton accounts in depository banks at which Hutton maintains a deposit relationship unless there are written agreements or consents of the banks authorizing such withdrawals.

6. An order restraining and enjoining the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., their

officers, agents, employees, directors, successors, assigns and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from withdrawing, by any means including the use of a multiplier or formula, from Hutton's accounts at depository banks funds in excess of funds actually received from customer or institutional clients in the ordinary course of business, unless there are written agreements or consents of the bank authorizing such withdrawals.

7. An order restraining and enjoining the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., their officers, agents, employees, directors, successors, assigns, and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from simultaneously drafting and issuing Hutton checks in identical amounts drawn on different banks, and cross-depositing each said check in the other bank, thereby causing each bank to certify next day opening balances in their account.

8. An order restraining and enjoining the defendants The E.F. Hutton Group Inc., and E.F. Hutton & Company Inc. their officers, agents, employees, directors, successors, assigns and all operating affiliates and subsidiaries actually controlled by them, and each of them, and all persons actively in concert or participating with them, from creating float by retarding,

delaying or obstructing the clearing of checks deposited in the defendant Hutton Company's branch or regional depository banks other than by way of stop orders, directions not to pay or other credit related techniques.

And for such other relief as this Court deems appropriate under the circumstances.

DATED this day of April 1985

Robert W. Ogren
Robert W. Ogren
Chief, Fraud Section
U.S. Department of Justice
Washington, D.C. 20530

Albert R. Murray
Albert R. Murray, Jr.
Assistant U.S. Attorney
Scranton, Pennsylvania

Peter B. Clark
Peter B. Clark
Trial Attorney
U.S. Department of Justice
Washington, D.C. 20530

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA,)
)
v.) CRIMINAL NO. 85-
)
E.F. HUTTON & COMPANY INC.) INFORMATION

The United States Attorney for the Middle District of Pennsylvania charges that:

INTRODUCTION

1. At all times material to this information, the defendant E.F. Hutton & Company Inc. ("Hutton Company"), a Delaware corporation and a wholly owned subsidiary of The E.F. Hutton Group Inc., maintained its principal offices at One Battery Park Plaza, New York, New York. The defendant Hutton Company is one of the nation's largest broker-dealers of securities and is registered with the, Securities and Exchange Commission pursuant to Section 15 of the Securities Exchange Act of 1934 [15 U.S.C. §78o]. The defendant's parent company, The E.F. Hutton Group Inc., is a publicly held corporation and its stock is registered with the Securities and Exchange Commission pursuant to Section 12 of the Securities Exchange Act of 1934 [15 U.S.C. §78l].

2. At all times material to this information, the defendant Hutton Company was organized into nine domestic and one international operating regions. These regions were:

Northeast Region in Boston, Massachusetts
Atlantic Region in New York, New York
Southeast Region in Atlanta, Georgia
Midwest Region in Chicago, Illinois
Central Region in Kansas City, Missouri

South Central Region in Houston, Texas
Mountain Region in Denver, Colorado
Pacific North Region in San Francisco, California
Pacific South Region in Los Angeles, California
International Region in Geneva, Switzerland

Each of these regions was supervised by a regional vice-president who reported directly to the defendant firm's president. In each of its domestic operating regions, the defendant Hutton Company maintained branch offices supervised by branch office managers. Regional and branch offices of the defendant Hutton Company also employed operations managers and cashiers who performed "back office" functions of the defendant's business. These regional and branch office operations managers and cashiers reported directly to their immediate supervisors, the regional vice-presidents and the branch office managers, and indirectly to the defendant Hutton Company's operations managers in New York City.

3. At all times material to this information, the defendant Hutton Company received from its individual and institutional customers, in the course of its business, between $40 million and $200 million each business day at its more than 300 branch offices located throughout the United States. Funds received from said customers were ordinarily first deposited in various local despository accounts maintained by the defendant Hutton Company in approximately 400 banks and financial institutions located throughout the United States.

4. As used herein, the terms "depository bank" and "depository account" shall mean the bank or account to which any instrument for the payment of money is transferred for collection. In

many cases, as more fully set forth below, the defendant Hutton Company's stated purpose in having its branches open such accounts at depository banks was to use these accounts for the collection and concentration of funds received from its customers, and it was the expectation of these depository banks that such accounts would be so used.

5. At all times material to this information, defendant Hutton Company instituted and maintained a domestic "cash concentration" system, the legitimate purpose of which was to collect funds received from the defendant Hutton Company's individual and institutional customers, to transfer those funds to regional depository bank accounts and thereafter to transfer those deposits to certain prime depository bank accounts maintained in New York City and Los Angeles, California.

6. In general terms, this system, which was also known as the "drawdown system", operated as follows:

(a) branch office cashiers of the defendant Hutton Company were instructed to calculate, on a daily basis, the net activity in their branch office's depository bank accounts and to transmit that information to their regional office cashiers. The regional offices maintained checks for each of the branch office depository accounts located in their regions, and the defendant Hutton Company's regional office personnel would thereafter prepare "depository transfer checks", or "DTC's", drawn upon each branch office depository account, and deposit these DTC's into the appropriate regional office depository bank accounts.

(b) following the process described in sub-paragraph "6(a)" above, the regional offices of the defendant Hutton Company would telephone the defendant's "Cash Desk" in New York City and report the aggregate net activity in the various regional depository bank accounts (which net activity included, as its primary component, the DTC's described above). Promptly thereafter, the Cash Desk would prepare DTC's drawn upon the regional depository bank accounts of the defendant Hutton Company's South Central, Southeast, Northeast and Atlantic regions and manually deposit those items into an account maintained at Manufacturers Hanover Trust Company, the defendant's prime concentration bank in New York City. Information as to the amount of funds deposited into the defendant Hutton Company's regional depository bank accounts for its Pacific North, Pacific South, Mountain, Central and Midwest regions was telexed by the Cash Desk in New York City to Bank of America, the defendant's prime concentration bank in Los Angeles, California. Bank of America, acting as agent for the defendant Hutton Company, immediately prepared DTC's drawn upon the aforesaid regional depository accounts for collection into the defendant's concentration account.

(c) at various times material herein, the defendant Hutton Company maintained "zero balance" accounts at United States Trust Company of New York and Chemical Bank in New York City and Bank of America in Los Angeles. By arrangement with these banks, the defendant Hutton Company was permitted to draw checks upon these accounts -- in which the defendant Hutton Company was required to keep no balance -- with the understanding that the defendant would, on a daily basis, wire transfer into these accounts sufficient funds to cover all checks presented against the accounts for payment.

COUNTS 1-100

SCHEME TO DEFRAUD

7. Beginning on or about July 1, 1980 and continuing through February 28, 1982, in the Middle District of Pennsylvania and elsewhere, the defendant Hutton Company devised and intended to devise a scheme and artifice to defraud and obtain money from various banks and financial institutions with which the defendant Hutton Company had established depository relationships, as more fully set forth below.

OBJECT OF THE SCHEME

8. The object of the defendant's scheme and artifice to defraud was to obtain interest free funds by means of intentional overdrafting of various of its depository bank accounts, in the manner and means more fully described herein.

MANNER AND MEANS OF EFFECTING THE SCHEME AND ARTIFICE TO DEFRAUD

9. It was part of said scheme and artifice to defraud that the defendant Hutton Company would fraudulently misuse its depository bank accounts, for the purpose of obtaining the interest-free use of bank funds, by the following activities,

including manipulating the check collection system and procedures of the Federal Reserve System and causing repeated and substantial drawings against uncollected funds:

(a) drawing down arbitrary amounts, unrelated to, and in excess of, the volume of customer funds deposited, and thereafter covering such excessive drawdowns by depositing checks drawn upon zero balance accounts of the defendant Hutton Company; and

(b) causing funds to be successively transferred between various branch and regional depository bank accounts of the defendant Hutton Company, prior to their deposit in a prime depository bank, thereby inflating the funds drawn down so that they exceeded the amount of customer funds originally deposited; and (i) utilizing in conjunction therewith formulas and methods by which the actual amount of customer funds was excessively multiplied or otherwise arbitrarily increased and (ii) exploiting the opportunities for delayed clearing times of items deposited into the defendant's branch and regional depository banks.

During the period from July 1, 1980 through February 28, 1982, the defendant Hutton Company's drawings against uncollected funds aggregated well in excess of $1 billion.

10. It was a further part of said scheme and artifice to defraud that the following manner and means were utilized to further the fraudulent misuse of the defendant Hutton Company's depository bank accounts described in paragraph "9." above:

(a) the draft, issue and negotiation of checks drawn upon certain of the defendant Hutton Company's branch and regional·depository accounts in arbitrary amounts unrelated to and in excess of the amounts shown upon the defendant's book balances for said accounts at the time of said draft, issue and negotiations; and

(b) covering the checks described in sub-paragraph "(a)" above by drafting checks upon zero balance accounts, and depositing said checks into the defendant Hutton Company's branch and regional depository banks for the purpose of concealing the arbitrary and excessive amount of overdrafts in said depository accounts; and

(c) causing uncollected funds to be withdrawn from certain of the defendant Hutton Company's branch and regional depository banks to such an extent as to produce a net ongoing uncollected balance at those banks without the prior agreement or consent of those banks authorizing said withdrawals.

11. Between July 1, 1980 and February 28, 1982, in the Middle District of Pennsylvania and elsewhere, the defendant Hutton Company, for the purpose of executing the scheme and artifice to defraud, and attempting to do so, did knowingly cause to be delivered by the United States Postal Service, according to the directions thereon, certain mail matter on 100 occasions.

All in violation of Title 18, United States Code, Section 1341.

COUNTS 101 - 2,000

12. Paragraphs "1." through "10." of Counts 1-100 of this information are hereby realleged and incorporated by reference as though fully set forth herein.

13. Between July 1, 1980 and February 28, 1982, in the Middle District of Pennsylvania and elsewhere, the defendant Hutton Company, for the purpose of executing the scheme and artifice to defraud, and attempting to do so, did knowingly transmit and cause to be transmitted by means of wire communications in interstate commerce, writings, signs, signals, pictures and sounds on 1,900 occasions.

All in violation of Title 18, United States Code, Section 1343.

James J West
JAMES J. WEST
United States Attorney

Robert W. Ogren
ROBERT W. OGREN
Chief, Fraud Section
Criminal Divison
U.S. Department of Justice

Albert R. Murray
ALBERT R. MURRAY, JR.
Assistant United States Attorney

Peter B Clark
PETER B. CLARK
Trial Attorney
U.S. Department of Justice

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

THE E.F. HUTTON GROUP INC.,
E.F. HUTTON & COMPANY INC.

Defendants.

CIVIL ACTION NO. 85-

CONSENT AND UNDERTAKING OF THE E.F. HUTTON GROUP INC. AND E.F. HUTTON & COMPANY INC.

1. The defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc.:

(i) admit the allegations of the Complaint;

(ii) admit the jurisdiction of this Court over them and over the subject matter of this action;

(iii) admit the service upon them of the Summons and Complaint in this action;

(iv) waive the filing of an Answer;

(v) waive the making of any Findings of Fact and Conclusions of Law under Rule 52 of the Federal Rules of Civil Procedure;

(vi) enter an appearance in this action; and

(vii) hereby consent to the entry of the attached Final Judgment of Permanent Injunction against them, in the form attached hereto as "Exhibit A", without further notice.

2. The defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. hereby waive any right they may have to appeal from the entry of a Final Judgment of Permanent Injunction.

3. The defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. enter into this Consent and Undertaking voluntarily, and no promise or threat of any kind whatsoever has been made by the United States of America or any officer, agent or representative thereof to induce The E.F. Hutton Group Inc. or E.F. Hutton & Company Inc. to enter into this Consent and Undertaking, other than those promises expressed in the Notice of Plea Agreement and Plea Agreement, a copy of which is attached hereto as "Exhibit B".

4. The defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. hereby undertake:

(a) That the defendant E.F. Hutton & Company Inc. ("Hutton Company") shall make full restitution, in accordance with paragraph "4" of the Plea Agreement dated April , 1985, to all banks and other financial institutions, whether or not such banks or financial institutions were federally chartered or insured, with which Hutton Company maintained a deposit relationship, during the period from July 1, 1980 through December 31, 1982, of all net uncompensated interest losses incurred by said banks or financial institutions as a result of Hutton Company having withdrawn uncollected funds from said banks and financial institutions without prior written agreement.

(b) That the defendant Hutton Company shall, within ninety (90) days of the entry of its plea of guilty in the attendant criminal proceeding, in accordance with paragraph "5." of the Plea Agreement, institute or further reiterate corporate procedures and policies, in writing, which shall prohibit its corporate directors, officers, employees and agents from engaging in the prohibited practices and transactions described in the Complaint herein and the Information in the attendant criminal proceeding.

(c) That the defendant Hutton Company shall, within ninety (90) days of the entry of its plea of guilty in the attendant criminal proceeding, in accordance with paragraph "6." of the Plea Agreement, file with the Court affidavits from each of its senior corporate officers and all other corporate officers having responsibility, directly or indirectly, for Hutton Company's money management practices and banking activities, as well as each branch office manager, branch office operations manager, branch office cashier, regional operations manager, regional cashier, regional interest specialist and regional business analyst, acknowledging that each has received and read a copy of this Consent and Undertaking and the Complaint herein, as well as the Plea Agreement and Information filed in the attendant criminal proceeding.

(d) That the defendant Hutton Company shall, within thirty (30) days of the entry of its plea of guilty, in accordance with paragraph "7." of the Plea Agreement, instruct its internal and outside auditors to design and institute special audit procedures for the purpose of detecting any future transactions and practices prohibited by the Final Judgment of Permanent Injunction herein.

(e) That the defendant Hutton Company shall, within one-hundred fifty (150) days of the entry of the plea of guilty, in accordance with paragraph "8." of the Plea Agreement, conduct instructional meetings for all of the corporate officers and employees described in subparagraph (c) above, at which meetings outside legal counsel and outside auditors, assisted by company counsel and auditors, shall review the activities heretofore engaged in by the defendant Hutton Company and shall thoroughly explain and review these civil proceedings, including the practices prohibited by the Final Judgment of Permanent Injunction herein, and the attendant criminal proceedings. The revised corporate procedures and policies instituted in accordance with subparagraph "(b)", above, shall also be thoroughly reviewed and explained at these meetings.

5. The defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. further consent and agree that this Consent and Undertaking shall be incorporated by reference in the Final Judgment of Permanent Injunction, in the form attached

hereto as "Exhibit A", to be entered by the Court in this action, and further agree that this Court shall retain jurisdiction in this matter for all purposes.

The E.F. Hutton Group Inc.

By:
Thomas P. Lynch
President

E.F. Hutton & Company Inc.

By: Scott Pierce
Scott Pierce
President

Witness:

Cahill Gordon & Reindel
80 Pine Street
New York, New York 10005
Attorneys for Defendants
The E.F. Hutton Group Inc. and
E.F. Hutton & Company Inc.

By: Thomas F. Curnin
Thomas F. Curnin

State of New York)
) ss.:
County of New York)

On this 30th day of April, 1985, before me personally came Thomas P. Lynch, who executed the foregoing Consent and Undertaking on behalf of The E.F. Hutton Group Inc. and he being by me duly sworn did depose and say he is the President of The E.F. Hutton Group Inc. and has been duly and properly authorized and empowered to make, execute and deliver the foregoing Consent and Undertaking on behalf of The E.F. Hutton Group Inc.

BARBARA K. HUNT
Notary Public, State of New York
No. 4812597
Qualified in Westchester County
Commission Expires March 30, 1986

Barbara K. Hunt
Notary Public

State of New York)
) ss.:
County of New York)

On this 30th day of April, 1985, before me personally came Scott Pierce, who executed the foregoing Consent and Undertaking on behalf of E.F. Hutton & Company Inc. and he being by me duly sworn did depose and say he is the President of E.F. Hutton & Company Inc. and has been duly and properly authorized and empowered to make, execute and deliver the foregoing Consent and Undertaking on behalf of E.F. Hutton & Company Inc.

BARBARA K. HUNT
Notary Public, State of New York
No. 1812590
Qualified in Westchester County
Commission Expires March 30, 1986

Notary Public

CERTIFIED COPY OF RESOLUTIONS

Authorization Re: Execution)
of Consent and Undertaking of)
The E.F. Hutton Group Inc.)

Upon the motion duly made, seconded and carried, the following resolutions were adopted:

> RESOLVED, that this Corporation, expecting to be named as a defendant in a civil action brought by the United States of America in the United States District Court for the Middle District of Pennsylvania, consents to a settlement of that action encompassing the entry of a Final Judgment of Permanent Injunction Against The E.F. Hutton Group Inc. in substantially the forms reviewed by this Board of Directors at this meeting; and
>
> RESOLVED FURTHER, that Thomas P. Lynch, President of this Corporation, be, and he hereby is, authorized to execute such Consent and Undertaking of The E.F. Hutton Group Inc. on behalf of this Corporation substantially in such form as reviewed by this Board of Directors at this meeting.

CERTIFICATION

I, THOMAS P. LYNCH, hereby certify that I am the duly elected Secretary of The E.F. Hutton Group Inc.; that the foregoing is a full, true and correct copy of resolutions duly adopted by the Board of Directors of said Corporation, at a meeting thereof duly held at the office of the Corporation, in New York, New York, on TUESDAY, the 30TH day of April, 1985, that the said resolutions have not been rescinded or revoked; and that the foregoing resolutions are not contrary to any provision in the Articles of Incorporation or By-Laws of The E.F. Hutton Group Inc.

IN WITNESS WHEREOF, I have hereunto signed my name as Secretary and affixed the Seal of said Corporation this 30TH day of April, 1985.

Secretary

CERTIFIED COPY OF RESOLUTIONS

**Authorization Re: Execution)
of Consent and Undertaking of)
E.F. Hutton & Company Inc.)**

Upon the motion duly made, seconded and carried, the following resolutions were adopted:

> **RESOLVED, that this Corporation, expecting to be named as a defendant in a civil action brought by the United States of America in the United States District Court for the Middle District of Pennsylvania, consents to a settlement of that action encompassing the entry of a Final Judgment of Permanent Injunction Against E.F. Hutton & Company Inc. in substantially the forms reviewed by this Board of Directors at this meeting; and**

> **RESOLVED FURTHER, that Scott Pierce, President of this Corporation, be, and he hereby is, authorized to execute such Consent and Undertaking of E.F. Hutton & Company Inc. on behalf of this Corporation substantially in such form as reviewed by this Board of Directors at this meeting.**

CERTIFICATION

I, THOMAS P. LYNCH, hereby certify that I am the duly elected Secretary of E.F. Hutton & Company Inc.; that the foregoing is a full, true and correct copy of resolutions duly adopted by the Board of Directors of said Corporation, at a meeting thereof duly held at the office of the Corporation, in New York, New York, on TUESDAY, the 30TH day of April, 1985, that the said resolutions have not been rescinded or revoked; and that the foregoing resolutions are not contrary to any provision in the Articles of Incorporation or By-Laws of E.F. Hutton & Company Inc.

IN WITNESS WHEREOF, I have hereunto signed my name as Secretary and affixed the Seal of said Corporation this 30TH day of April, 1985.

Secretary

Exhibit A

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA, Plaintiff, v. THE E.F. HUTTON GROUP INC., E.F. HUTTON & COMPANY INC. Defendants.	CIVIL NO. 85- FINAL JUDGMENT OF PERMANENT INJUNCTION AGAINST THE E.F. HUTTON GROUP INC. AND E.F. HUTTON & COMPANY INC.

Plaintiff, the United States of America, having duly commenced this action by filing its Complaint for Permanent Injunction and Ancillary Relief ("Complaint") and defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. ("Hutton Group" and "Hutton Company") having appeared and admitted to the jurisdiction of this Court over them and over the subject matter of this action; having waived the making of any findings of fact or conclusions of law; before the taking of any testimony and without trial, argument or adjudication of any issue of fact or law herein; admitting the allegations of the Complaint; having consented to the entry of this Final Judgment of Permanent Injunction; and having entered into certain undertakings contained in the Consent and Undertaking of The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. annexed hereto and incorporated herein, it is hereby:

I

ORDERED, ADJUDGED AND DECREED that The E.F. Hutton Group Inc., E.F. Hutton & Company Inc., their directors, officers, agents, employees, successors, assigns and all operating affiliates and subsidiaries actually controlled by them, and those persons in active concert or participation with them, and each of them, are hereby permanently restrained and enjoined from:

[1] violating Section 1341 of Title 18 of the United States Code by, directly or indirectly, knowingly devising or intending to devise any scheme or artifice to defraud, for the purpose of obtaining money or property, for the benefit of Hutton Group or Hutton Company, by means of false or fraudulent pretenses, representations, or promises, and, for the purpose of executing such scheme or artifice or attempting so to do, placing in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or taking or receiving therefrom, any such matter or thing, or knowingly causing to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing; and

[2] violating Section 1343 of Title 18 of the United States Code by directly or indirectly, knowingly devising or intending to devise any scheme or artifice to defraud, or for the purpose of obtaining money or property, for the benefit of Hutton Group or Hutton Company, by means of false or fraudulent pretenses,

representations, or promises, transmitting or causing to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice; and

[3] violating Section 1344 of Title 18 of the United States Code by, directly or indirectly, knowingly executing or attempting to execute a scheme or artifice:

(a) to defraud any federally chartered or insured financial institution; or

(b) to obtain, for Hutton Group or Hutton Company, any of the moneys, funds, credits, assets, securities or other property owned by or under the custody or control of a federally chartered or insured financial institution by means of false or fraudulent pretenses, representations, or promises.

II

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that The E.F. Hutton Group Inc., E.F. Hutton & Company Inc., their directors, officers, agents, employees, successors, assigns and all operating affiliates and subsidiaries actually controlled by them, and those persons in active concert or participation with them, and each of them, are hereby permanently restrained and enjoined from:

[1] failing to disclose and describe, in writing, to each bank or financial institution with which they maintain a depository account, all money management practices or techniques

which may affect, directly or indirectly, the use of such account in connection with the concentration of funds, including, without limitation, intra-company transfers of funds into and out of such account; and

[2] drawing down, from any Hutton account at a depository bank, arbitrary amounts by means of overdraft checks unrelated to the volume of customer funds deposited, and thereafter covering such drawdowns by checks drawn upon another of Hutton's accounts; and

[3] causing funds to be successively transferred between defendants' various branch and regional bank accounts, prior to their deposit in a prime depository bank, in order to inflate the funds drawn down so that they exceed the amount of customer funds originally deposited; and (i) utilizing in conjunction therewith formulas and methods by which the actual amount of customer funds are excessively multiplied or otherwise arbitrarily increased and (ii) thereby exploiting the opportunities for delayed clearing times of items deposited into the defendants' branch depository banks; and

[4] causing uncollected funds to be withdrawn by any means, including the use of a multiplier or formula, from Hutton accounts in depository banks at which Hutton maintains a deposit relationship unless there are written agreements or consents of the banks authorizing such withdrawals; and

[5] withdrawing, by any means including the use of a multiplier or formula, from Hutton's accounts at depository banks funds in excess of funds actually received from customer or institutional clients in the ordinary course of business, unless there are written agreements or consents of the banks authorizing such withdrawals; and

[6] creating float by retarding, delaying or obstructing the clearing of checks deposited in the defendants' branch or regional depository banks other than by way of stop orders, directions not to pay or other credit related techniques; and

[7] simultaneously drafting and issuing Hutton checks in identical amounts drawn on different banks, and cross-depositing each said check in the other bank, thereby causing each bank to certify next day opening balances in their account.

The prohibitions described in paragraphs "[2]" through "[7]" above shall take effect with the entry of this injunction; the prohibition described in paragraph "[1]" above shall take effect ninety (90) days after the date of this injunction.

III

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the annexed Consent and Undertaking of The E.F. Hutton Group, Inc. and E.F. Hutton & Company, Inc. be, and the same hereby is, incorporated herein with the same force and effect as if fully set forth herein.

IV

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. shall fully comply with their undertakings as set forth in the attached Consent and Undertaking of The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc.

V

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that this Court shall retain jurisdiction of this matter for all purposes.

UNITED STATES DISTRICT JUDGE

DATED: April , 1985

Harrisburg, Pennsylvania

Exhibit B

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA, Plaintiff, v. E.F. HUTTON & COMPANY INC. Defendant.	CRIMINAL NO. 85- Violations: 18 U.S.C. §§1341 and 1343 NOTICE OF PLEA AGREEMENT AND PLEA AGREEMENT

Pursuant to Rule 11 of the Federal Rules of Criminal Procedure, notice is respectfully given to the Court that the attorneys for the Government and the attorneys for The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. have engaged in discussions pursuant to said rule and agree:

1. E.F. Hutton & Company Inc. will waive venue and indictment and plead guilty in the United States District Court for the Middle District of Pennsylvania to each of the 2,000 counts of the Information, attached hereto as "Exhibit A", which charges criminal violations of the federal mail and wire fraud statutes, 18 U.S.C. §§1341 and 1343.

2. Pursuant to the provisions of Rule 11(e)(1)(C) of the Federal Rules of Criminal Procedure, E.F. Hutton & Company Inc. will:

(a) Pay a criminal fine in the amount of two million dollars ($2,000,000.) for violations of 18 U.S.C. §§1341 and 1343, as alleged in

Counts 1 through 2,000 of Exhibit A.

(b) Pay to the United States an additional seven hundred fifty thousand dollars ($750,000.) as compensation to the United States for the costs of investigation and prosecution.

The total of said criminal penalty and costs of prosecution shall be in the amount of two million seven hundred and fifty thousand dollars ($2,750,000.) and such amount shall be paid in full within five (5) days after the entry of final judgment hereon.

3. If the Court accepts the plea of guilty described and referred to in paragraph "1." above and imposes the sentence described and referred to in paragraph "2." above,

(a) The United States of America agrees that no further criminal charges will be brought against The E.F. Hutton Group Inc., E.F. Hutton & Company Inc., their present or past subsidiaries, divisions or affiliates, as well as the past and present directors, employees, officers, or agents of any of them, for any of the bank related practices, techniques or transactions which were the subject of, or otherwise disclosed in investigations by grand juries in the Middle District of Pennsylvania and the Western District of New York. However, no provision of this sub-paragraph shall prevent or preclude the United States from presenting charges for perjury or false statement against any person or entity for knowingly having provided false information to any law enforcement agent in connection with the investigation by Grand Jury No. 83-142, to the Grand Jury or in any other judicial proceeding.

(b) The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. agree that this agreement shall not prevent, prejudice or preclude the United States from proceeding in the future with the investigation and prosecution of any federal criminal violations by The E.F. Hutton Group Inc. or E.F. Hutton & Company Inc., their present or past subsidiaries, divisions or affiliates, as well as their past and present directors, employees, officers, or agents of any of them, occurring after the date of this agreement, whether or not such transactions shall be similar to or in continuation of the activities described in the Information attached hereto as Exhibit A.

4. The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. agree that E.F. Hutton & Company Inc. ("Hutton Company") shall make full restitution to all banks and financial institutions with which it maintained a deposit relationship,

during the period from July 1, 1980 through December 31, 1982, (such banks and financial institutions being hereinafter referred to as the "Banks", and the period from July 1, 1980 through December 31, 1982 being hereinafter referred to as the "Period") of net uncompensated interest losses for the Period incurred by said Banks as a result of Hutton Company having withdrawn uncollected funds from said Banks without prior written agreement. Said restitution shall be made as follows:

(a) Hutton Company agrees to the appointment of a Special Master and agrees to compensate said Special Master for the reasonable value of his/her services and the cost or expense of employing such other persons including auditing and banking experts who the Special Master may retain to assist him/her in fulfilling the responsibilities of his/her appointment. All claims for compensation by the Special Master shall be rendered to the Court herein and, provided the Court shall approve the amounts claimed for payment, said claims shall be paid by Hutton Company within five (5) days of such approval. Hutton Company agrees that the Court's determination of the Special Master's compensation shall be final.

(b) Within thirty (30) days of the date of this agreement the parties shall agree upon a designee to serve as the Special Master. In the event the parties are unable to agree, the Court shall designate the Special Master from a list of candidates offered by the United States and Hutton Company.

(c) Within thirty (30) days of the appointment of the Special Master by the Court herein, Hutton Company shall mail, by certified mail, return receipt requested, to each Bank with which it maintained a deposit relationship during the Period, a letter, in the form annexed hereto as "Exhibit B", as well as copies of all papers filed with the Court in this proceeding and the attendant civil injunctive proceedings.

(d) Any Bank may, within forty-five (45) days from the date of the mailing, or at such later time as the Bank and Hutton Company may agree, request participation in this restitution program by returning a letter, substantially in the form annexed hereto as "Exhibit B-1", to the Special Master, with a copy thereof to Hutton Company.

(e) Within sixty (60) days after receiving a request to participate from a given Bank, or within such further time as the Bank and Hutton Company may agree, Hutton Company, if requested, shall provide such Bank with copies (to the extent they are in Hutton

Company's possession, custody, or control) of (1) the Hutton Company general ledger statements, (2) the bank statements, (3) the cash receipt and disbursement blotters and (4) all depository transfer checks and deposit items for each Hutton Company account maintained at the Bank during the Period.

(f) Within sixty (60) days after Hutton Company shall have furnished to a Bank all of the records set forth in "(e)", or within such later time as the Bank and Hutton Company may agree, the Bank shall file with the Special Master, and with Hutton Company, its claim for restitution in the form annexed hereto as "Exhibit B-2".

(g) The failure of any Bank to file a claim pursuant to the terms hereof shall not constitute a waiver by said Bank of any claim which it may have against Hutton Company for the acts and practices which are the subject of the Information herein or of the Complaint filed in the attendant civil injunctive proceeding. The filing by any Bank of a request to participate with the Special Master, pursuant to the terms of this Plea Agreement, shall, however, constitute a waiver by said Bank of monetary recovery for losses sustained during the Period other than pursuant to this restitution program. Any Bank or financial institution which shall determine not to file a request to participate pursuant to the terms of this Plea Agreement shall retain all rights which it may otherwise have against Hutton Company.

(h) Notwithstanding the filing of any claim pursuant to the terms of this Plea Agreement, Hutton Company and any claimant Bank shall be free to reach a negotiated settlement of any claim filed hereunder prior to the time a final determination on that claim is made by the Special Master. If any such negotiated settlement is made, either party thereto shall so notify the Special Master, in writing.

(i) By filing a claim pursuant to the terms of this Plea Agreement, a Bank shall agree to furnish to Hutton Company, within thirty (30) days of filing any claim hereunder, or within such later time as the Bank and Hutton Company may agree, all relevant records or information required to substantiate its claim in accordance with the procedures set forth in Exhibit C hereto.

(j) After completing the exchange of documents contemplated by (e) and (i) hereof, Hutton Company and the Bank shall have 90 days, or within such later time as the Bank and Hutton Company shall agree, to conduct such discovery, if any, as they may require unless the Special Master deems it inappropriate. Thereafter, the Special Master may schedule a hearing and shall determine the amount of restitution, if any, to which a claimant Bank shall be entitled pursuant to the procedures set forth in Exhibit C hereto.

(k) At his/her discretion, the Special Master may direct that any hearings with respect to claims submitted by a claimant Bank shall be consolidated or coordinated on such terms as he/she shall deem appropriate.

(l) The determination of any claim by the Special Master shall be final. However, in any instance in which it may appear to the Special Master, to Hutton Company or to the claimant Bank that the Special Master may have a conflict of interest, or that his/her application of the formula set forth in Exhibit C hereto was manifestly irrational, either Hutton Company or the Bank shall have the right to apply to the Court within twenty (20) days, for consideration of a particular claim.

(m) The Special Master shall notify Hutton Company and the claimant Bank, in writing of his/her determination of the appropriate amount of restitution for that Bank's claim. Hutton Company agrees to pay the claimant Bank the amount so determined by the Special Master within thirty (30) days of the date it is notified of the Special Master's determination. In the event item "(1)" applies, the concerned party shall seek judicial review within twenty (20) days after the Special Master's ruling, and payment shall aoide the outcome of such review.

5. The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. agree that Hutton Company shall, within ninety (90) days of the entry of the plea of guilty, institute or further reiterate, in writing, corporate procedures and policies which shall pronibit its corporate directors, officers, employees and agents from engaging in the prohibited practices and transactions described in the Information herein and in the Complaint and Final Judgment of Permanent Injunction in the attendant civil injunctive proceeding, annexed hereto as "Exhibit D".

6. The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. agree that Hutton Company shall, within ninety (90) days of the entry of the plea of guilty, file with the Court affidavits

from each of its senior corporate officers and all other corporate officers responsible, directly or indirectly, for Hutton Company's money management practices and banking activities, as well as each branch office manager, branch office operations manager, branch office cashier, regional operations manager, regional cashier, regional interest specialist and regional business analyst, acknowledging that each has received and read a copy of this Plea Agreement, the Information to be filed herein, and all papers filed with the Court in the attendant civil injunctive proceeding.

7. The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. agree that Hutton Company shall, within thirty (30) days of the entry of the plea of guilty, instruct its internal and outside auditors to design and institute special audit procedures for the purpose of detecting any prohibited practices and transactions described in the Information and in the Complaint and Final Judgment of Permanent Injunction filed with the Court in the attendant civil injunctive proceeding.

8. The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. agree that Hutton Company shall, within one-hundred fifty (150) days of its entry of the plea of guilty, conduct instructional meetings for all of the personnel described in paragraph "6" above, at which meetings outside legal counsel and outside auditors, with the assistance of company counsel and auditors, shall review the activities heretofore conducted by

Hutton Company and shall thoroughly explain and review these criminal proceedings and the attendant civil injunctive proceedings. The revised corporate procedures and policies, instituted in accordance with paragraph "5", above, shall also be thoroughly reviewed and explained at these meetings.

9. It is agreed that if the Court, pursuant to Rule 11(e)(4) of the Federal Rules of Criminal procedure, rejects any part of the plea agreement or refuses to accept the guilty plea, The E.F. Hutton Group Inc., E.F. Hutton & Company Inc. and the United States will be relieved of any obligations of this Plea Agreement. It is further agreed that if the Court rejects this Plea Agreement, the United States may move to dismiss the charges without prejudice and Hutton will have no objection to such a dismissal nor any objection, on the basis of such dismissal of the charges, to the continuation of the Grand Jury's investigation or to the return of an indictment containing additional charges.

10. It is expressly understood and agreed that the provisions of paragraph "3(a)" in no way preclude the United States from prosecuting Hutton for any civil or criminal violation of Title 26 of the United States Code, whether or not arising out of the same facts and circumstances charged in the Information or referred to in paragraph "3(a)" above.

11. This Plea Agreement confirms the entire agreement between Hutton and the United States with respect to the aforesaid guilty plea and no other promises, representations or inducements have been made to Hutton or its attorneys with regard to such guilty plea.

DATED this day of April, 1985

Stephen S. Trott
Assistant Attorney General
Criminal Division
U.S. Department of Justice

Robert W. Ogren

Robert W. Ogren
Chief, Fraud Section
U.S. Department of Justice
Washington, D.C. 20530

Albert R. Murray, Jr.
Assistant U.S. Attorney
Scranton, Pennsylvania

Peter B. Clark

Peter B. Clark
Trial Attorney
U.S. Department of Justice
Washington, D.C. 20530

The E.F. Hutton Group Inc.

By:

Thomas P. Lynch
President

E.F. Hutton & Company Inc.

By:

Scott Pierce
President

Thomas F. Curnin

William G. Hundley

Attorneys for The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc.

State of New York)
) ss.:
County of New York)

On this day of April, 1985, before me personally came Scott Pierce, who executed the foregoing Plea Agreement on behalf of E.F. Hutton & Company Inc. and he being by me duly sworn did depose and say he is the President of E.F. Hutton & Company Inc. and has been duly and properly authorized and empowered to make, execute and deliver the foregoing Plea Agreement on behalf of E.F. Hutton & Company Inc.

Notary Public

State of New York)
) ss.:
County of New York)

On this day of April, 1985, before me personally came Thomas P. Lynch, who executed the foregoing Plea Agreement on behalf of The E.F. Hutton Group Inc. and he being by me duly sworn did depose and say he is the President of The E.F. Hutton Group Inc. and has been duly and properly authorized and empowered to make, execute and deliver the foregoing Plea Agreement on behalf of The E.F. Hutton Group Inc.

Notary Public

CERTIFIED COPY OF RESOLUTIONS

Authorization Re: Execution)
of Plea Agreement by)
E.F. Hutton & Company Inc.)

Upon the motion duly made, seconded and carried, the following resolutions were adopted:

> RESOLVED, that this Corporation, expecting to be named as a defendant in a criminal action brought by the United States of America in the United States District Court for the Middle District of Pennsylvania, consents to a settlement of that action encompassing a plea of guilty to an information pursuant to a Plea Agreement in substantially the forms reviewed by this Board of Directors at this meeting; and
>
> RESOLVED FURTHER, that Scott Pierce, President of this Corporation, be, and he hereby is, authorized to execute such Plea Agreement and enter a plea of guilty to an Information on behalf of this Corporation substantially in such forms as reviewed by this Board of Directors at this meeting.

CERTIFICATION

I, , hereby certify that I am the duly elected Secretary of E.F. Hutton & Company Inc.; that the foregoing is a full, true and correct copy of resolutions duly adopted by the Board of Directors of said Corporation, at a meeting thereof duly held at the office of the Corporation, in New York, New York, on , the day of April, 1985, that the said resolutions have not been rescinded or revoked; and that the foregoing resolutions are not contrary to any provision in the Articles of Incorporation or By-Laws of E.F. Hutton & Company Inc.

IN WITNESS WHEREOF, I have hereunto signed my name as Secretary and affixed the Seal of said Corporation this day of April, 1985.

Secretary

CERTIFIED COPY OF RESOLUTIONS

Authorization Re: Execution)
of Plea Agreement by)
The E.F. Hutton Group Inc.)

Upon the motion duly made, seconded and carried, the following resolutions were adopted:

RESOLVED, that this Corporation, in connection with a criminal action brought by the United States of America in the United States District Court for the Middle District of Pennsylvania, consents to the execution of a Plea Agreement whereby E.F. Hutton Company Inc. shall plead guilty to an Information in substantially the forms reviewed by this Board of Directors at this meeting; and

RESOLVED FURTHER, that Thomas P. Lynch, President of this Corporation, be, and he hereby is, authorized to execute such Plea Agreement of The E.F. Hutton Group Inc. on behalf of this Corporation substantially in such form as reviewed by this Board of Directors at this meeting.

CERTIFICATION

I, , hereby certify that I am the duly elected Secretary of The E.F. Hutton Group Inc.; that the foregoing is a full, true and correct copy of resolutions duly adopted by the Board of Directors of said Corporation, at a meeting thereof duly held at the office of the Corporation, in New York, New York, on , the day of April, 1985, that the said resolutions have not been rescinded or revoked; and that the foregoing resolutions are not contrary to any provision in the Articles of Incorporation or By-Laws of The E.F. Hutton Group Inc.

IN WITNESS WHEREOF, I have hereunto signed my name as Secretary and affixed the Seal of said Corporation this day of April, 1985.

____

Secretary

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

THE E.F. HUTTON GROUP INC.,
E.F. HUTTON & COMPANY INC.

Defendants

CIVIL NO. 85-

FINAL JUDGMENT OF PERMANENT
INJUNCTION AGAINST
THE E.F. HUTTON GROUP INC. AND
E.F. HUTTON & COMPANY INC.

Plaintiff, the United States of America, having duly commenced this action by filing its Complaint for Permanent Injunction and Ancillary Relief ("Complaint") and defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. ("Hutton Group" and "Hutton Company") having appeared and admitted to the jurisdiction of this Court over them and over the subject matter of this action; having waived the making of any findings of fact or conclusions of law; before the taking of any testimony and without trial, argument or adjudication of any issue of fact or law herein; admitting the allegations of the Complaint; having consented to the entry of this Final Judgment of Permanent Injunction; and having entered into certain undertakings contained in the Consent and Undertaking of The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. annexed hereto and incorporated herein, it is hereby:

I

ORDERED, ADJUDGED AND DECREED that The E.F. Hutton Group Inc., E.F. Hutton & Company Inc., their directors, officers, agents, employees, successors, assigns and all operating affiliates and subsidiaries actually controlled by them, and those persons in active concert or participation with them, and each of them, are hereby permanently restrained and enjoined from:

[1] violating Section 1341 of Title 18 of the United States Code by, directly or indirectly, knowingly devising or intending to devise any scheme or artifice to defraud, for the purpose of obtaining money or property, for the benefit of Hutton Group or Hutton Company, by means of false or fraudulent pretenses, representations, or promises, and, for the purpose of executing such scheme or artifice or attempting so to do, placing in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or taking or receiving therefrom, any such matter or thing, or knowingly causing to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing; and

[2] violating Section 1343 of Title 18 of the United States Code by directly or indirectly, knowingly devising or intending to devise any scheme or artifice to defraud, or for the purpose of obtaining money or property, for the benefit of Hutton Group or Hutton Company, by means of false or fraudulent pretenses,

representations, or promises, transmitting or causing to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice; and

[3] violating Section 1344 of Title 18 of the United States Code by, directly or indirectly, knowingly executing or attempting to execute a scheme or artifice:

(a) to defraud any federally chartered or insured financial institution; or

(b) to obtain, for Hutton Group or Hutton Company, any of the moneys, funds, credits, assets, securities or other property owned by or under the custody or control of a federally chartered or insured financial institution by means of false or fraudulent pretenses, representations, or promises.

II

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that The E.F. Hutton Group Inc., E.F. Hutton & Company Inc., their directors, officers, agents, employees, successors, assigns and all operating affiliates and subsidiaries actually controlled by them, and those persons in active concert or participation with them, and each of them, are hereby permanently restrained and enjoined from:

[1] failing to disclose and describe, in writing, to each bank or financial institution with which they maintain a depository account, all money management practices or techniques

which may affect, directly or indirectly, the use of such account in connection with the concentration of funds, including, without limitation, intra-company transfers of funds into and out of such account; and

[2] drawing down, from any Hutton account at a depository bank, arbitrary amounts by means of overdraft checks unrelated to the volume of customer funds deposited, and thereafter covering such drawdowns by checks drawn upon another of Hutton's accounts; and

[3] causing funds to be successively transferred between defendants' various branch and regional bank accounts, prior to their deposit in a prime depository bank, in order to inflate the funds drawn down so that they exceed the amount of customer funds originally deposited; and (i) utilizing in conjunction therewith formulas and methods by which the actual amount of customer funds are excessively multiplied or otherwise arbitrarily increased and (ii) thereby exploiting the opportunities for delayed clearing times of items deposited into the defendants' branch depository banks; and

[4] causing uncollected funds to be withdrawn by any means, including the use of a multiplier or formula, from Hutton accounts in depository banks at which Hutton maintains a deposit relationship unless there are written agreements or consents of the banks authorizing such withdrawals; and

[5] withdrawing, by any means including the use of a multiplier or formula, from Hutton's accounts at depository banks funds in excess of funds actually received from customer or institutional clients in the ordinary course of business, unless there are written agreements or consents of the banks authorizing such withdrawals; and

[6] creating float by retarding, delaying or obstructing the clearing of checks deposited in the defendants' branch or regional depository banks other than by way of stop orders, directions not to pay or other credit related techniques; and

[7] simultaneously drafting and issuing Hutton checks in identical amounts drawn on different banks, and cross-depositing each said check in the other bank, thereby causing each bank to certify next day opening balances in their account.

The prohibitions described in paragraphs "[2]" through "[7]" above shall take effect with the entry of this injunction; the prohibition described in paragraph "[1]" above shall take effect ninety (90) days after the date of this injunction.

III

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the annexed Consent and Undertaking of The E.F. Hutton Group, Inc. and E.F. Hutton & Company, Inc. be, and the same hereby is, incorporated herein with the same force and effect as if fully set forth herein.

IV

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the defendants The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. shall fully comply with their undertakings as set forth in the attached Consent and Undertaking of The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc.

V

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that this Court shall retain jurisdiction of this matter for all purposes.

UNITED STATES DISTRICT JUDGE

DATED: April , 1985
Harrisburg, Pennsylvania

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

UNITED STATES OF AMERICA,
Plaintiff,
v.
E.F. HUTTON & COMPANY INC.
Defendant.

CRIMINAL NO. 85-
Violations: 18 U.S.C. §§1341 and 1343

NOTICE OF PLEA AGREEMENT
AND PLEA AGREEMENT

Pursuant to Rule 11 of the Federal Rules of Criminal Procedure, notice is respectfully given to the Court that the attorneys for the Government and the attorneys for The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. have engaged in discussions pursuant to said rule and agree:

1. E.F. Hutton & Company Inc. will waive venue and indictment and plead guilty in the United States District Court for the Middle District of Pennsylvania to each of the 2,000 counts of the Information, attached hereto as "Exhibit A", which charges criminal violations of the federal mail and wire fraud statutes, 18 U.S.C. §§1341 and 1343.

2. Pursuant to the provisions of Rule 11(e)(1)(C) of the Federal Rules of Criminal Procedure, E.F. Hutton & Company Inc. will:

(a) Pay a criminal fine in the amount of two million dollars ($2,000,000.) for violations of 18 U.S.C. §§1341 and 1343, as alleged in

Counts 1 through 2,000 of Exhibit A.

(b) Pay to the United States an additional seven hundred fifty thousand dollars ($750,000.) as compensation to the United States for the costs of investigation and prosecution.

The total of said criminal penalty and costs of prosecution shall be in the amount of two million seven hundred and fifty thousand dollars ($2,750,000.) and such amount shall be paid in full within five (5) days after the entry of final judgment hereon.

3. If the Court accepts the plea of guilty described and referred to in paragraph "1." above and imposes the sentence described and referred to in paragraph "2." above,

(a) The United States of America agrees that no further criminal charges will be brought against The E.F. Hutton Group Inc., E.F. Hutton & Company Inc., their present or past subsidiaries, divisions or affiliates, as well as the past and present directors, employees, officers, or agents of any of them, for any of the bank related practices, techniques or transactions which were the subject of, or otherwise disclosed in investigations by grand juries in the Middle District of Pennsylvania and the Western District of New York. However, no provision of this sub-paragraph shall prevent or preclude the United States from presenting charges for perjury or false statement against any person or entity for knowingly having provided false information to any law enforcement agent in connection with the investigation by Grand Jury No. 83-142, to the Grand Jury or in any other judicial proceeding.

(b) The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. agree that this agreement shall not prevent, prejudice or preclude the United States from proceeding in the future with the investigation and prosecution of any federal criminal violations by The E.F. Hutton Group Inc. or E.F. Hutton & Company Inc., their present or past subsidiaries, divisions or affiliates, as well as their past and present directors, employees, officers, or agents of any of them, occurring after the date of this agreement, whether or not such transactions shall be similar to or in continuation of the activities described in the Information attached hereto as Exhibit A.

4. The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. agree that E.F. Hutton & Company Inc. ("Hutton Company") shall make full restitution to all banks and financial institutions with which it maintained a deposit relationship,

during the period from July 1, 1980 through December 31, 1982, (such banks and financial institutions being hereinafter referred to as the "Banks", and the period from July 1, 1980 through December 31, 1982 being hereinafter referred to as the "Period") of net uncompensated interest losses for the Period incurred by said Banks as a result of Hutton Company having withdrawn uncollected funds from said Banks without prior written agreement. Said restitution shall be made as follows:

(a) Hutton Company agrees to the appointment of a Special Master and agrees to compensate said Special Master for the reasonable value of his/her services and the cost or expense of employing such other persons including auditing and banking experts who the Special Master may retain to assist him/her in fulfilling the responsibilities of his/her appointment. All claims for compensation by the Special Master shall be rendered to the Court herein and, provided the Court shall approve the amounts claimed for payment, said claims shall be paid by Hutton Company within five (5) days of such approval. Hutton Company agrees that the Court's determination of the Special Master's compensation shall be final.

(b) Within thirty (30) days of the date of this agreement the parties shall agree upon a designee to serve as the Special Master. In the event the parties are unable to agree, the Court shall designate the Special Master from a list of candidates offered by the United States and Hutton Company.

(c) Within thirty (30) days of the appointment of the Special Master by the Court herein, Hutton Company shall mail, by certified mail, return receipt requested, to each Bank with which it maintained a deposit relationship during the Period, a letter, in the form annexed hereto as "Exhibit B", as well as copies of all papers filed with the Court in this proceeding and the attendant civil injunctive proceedings.

(d) Any Bank may, within forty-five (45) days from the date of the mailing, or at such later time as the Bank and Hutton Company may agree, request participation in this restitution program by returning a letter, substantially in the form annexed hereto as "Exhibit B-1", to the Special Master, with a copy thereof to Hutton Company.

(e) Within sixty (60) days after receiving a request to participate from a given Bank, or within such further time as the Bank and Hutton Company may agree, Hutton Company, if requested, shall provide such Bank with copies (to the extent they are in Hutton

Company's possession, custody, or control) of (1) the Hutton Company general ledger statements, (2) the bank statements, (3) the cash receipt and disbursement blotters and (4) all depository transfer checks and deposit items for each Hutton Company account maintained at the Bank during the Period.

(f) Within sixty (60) days after Hutton Company shall have furnished to a Bank all of the records set forth in "(e)", or within such later time as the Bank and Hutton Company may agree, the Bank shall file with the Special Master, and with Hutton Company, its claim for restitution in the form annexed hereto as "Exhibit B-2".

(g) The failure of any Bank to file a claim pursuant to the terms hereof shall not constitute a waiver by said Bank of any claim which it may have against Hutton Company for the acts and practices which are the subject of the Information herein or of the Complaint filed in the attendant civil injunctive proceeding. The filing by any Bank of a request to participate with the Special Master, pursuant to the terms of this Plea Agreement, shall, however, constitute a waiver by said Bank of monetary recovery for losses sustained during the Period other than pursuant to this restitution program. Any Bank or financial institution which shall determine not to file a request to participate pursuant to the terms of this Plea Agreement shall retain all rights which it may otherwise have against Hutton Company.

(h) Notwithstanding the filing of any claim pursuant to the terms of this Plea Agreement, Hutton Company and any claimant Bank shall be free to reach a negotiated settlement of any claim filed hereunder prior to the time a final determination on that claim is made by the Special Master. If any such negotiated settlement is made, either party thereto shall so notify the Special Master, in writing.

(i) By filing a claim pursuant to the terms of this Plea Agreement, a Bank shall agree to furnish to Hutton Company, within thirty (30) days of filing any claim hereunder, or within such later time as the Bank and Hutton Company may agree, all relevant records or information required to substantiate its claim in accordance with the procedures set forth in Exhibit C hereto.

(j) After completing the exchange of documents contemplated by (e) and (i) hereof, Hutton Company and the Bank shall have 90 days, or within such later time as the Bank and Hutton Company shall agree, to conduct such discovery, if any, as they may require unless the Special Master deems it inappropriate. Thereafter, the Special Master may schedule a hearing and shall determine the amount of restitution, if any, to which a claimant Bank shall be entitled pursuant to the procedures set forth in Exhibit C hereto.

(k) At his/her discretion, the Special Master may direct that any hearings with respect to claims submitted by a claimant Bank shall be consolidated or coordinated on such terms as he/she shall deem appropriate.

(l) The determination of any claim by the Special Master shall be final. However, in any instance in which it may appear to the Special Master, to Hutton Company or to the claimant Bank that the Special Master may have a conflict of interest, or that his/her application of the formula set forth in Exhibit C hereto was manifestly irrational, either Hutton Company or the Bank shall have the right to apply to the Court within twenty (20) days, for consideration of a particular claim.

(m) The Special Master shall notify Hutton Company and the claimant Bank, in writing of his/her determination of the appropriate amount of restitution for that Bank's claim. Hutton Company agrees to pay the claimant Bank the amount so determined by the Special Master within thirty (30) days of the date it is notified of the Special Master's determination. In the event item "(1)" applies, the concerned party shall seek judicial review within twenty (20) days after the Special Master's ruling, and payment shall abide the outcome of such review.

5. The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. agree that Hutton Company shall, within ninety (90) days of the entry of the plea of guilty, institute or further reiterate, in writing, corporate procedures and policies which shall prohibit its corporate directors, officers, employees and agents from engaging in the prohibited practices and transactions described in the Information herein and in the Complaint and Final Judgment of Permanent Injunction in the attendant civil injunctive proceeding, annexed hereto as "Exhibit D".

6. The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. agree that Hutton Company shall, within ninety (90) days of the entry of the plea of guilty, file with the Court affidavits

from each of its senior corporate officers and all other corporate officers responsible, directly or indirectly, for Hutton Company's money management practices and banking activities, as well as each branch office manager, branch office operations manager, branch office cashier, regional operations manager, regional cashier, regional interest specialist and regional business analyst, acknowledging that each has received and read a copy of this Plea Agreement, the Information to be filed herein, and all papers filed with the Court in the attendant civil injunctive proceeding.

7. The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. agree that Hutton Company shall, within thirty (30) days of the entry of the plea of guilty, instruct its internal and outside auditors to design and institute special audit procedures for the purpose of detecting any prohibited practices and transactions described in the Information and in the Complaint and Final Judgment of Permanent Injunction filed with the Court in the attendant civil injunctive proceeding.

8. The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. agree that Hutton Company shall, within one-hundred fifty (150) days of its entry of the plea of guilty, conduct instructional meetings for all of the personnel described in paragraph "6" above, at which meetings outside legal counsel and outside auditors, with the assistance of company counsel and auditors, shall review the activities heretofore conducted by

Hutton Company and shall thoroughly explain and review these criminal proceedings and the attendant civil injunctive proceedings. The revised corporate procedures and policies, instituted in accordance with paragraph "5", above, shall also be thoroughly reviewed and explained at these meetings.

9. It is agreed that if the Court, pursuant to Rule 11(e)(4) of the Federal Rules of Criminal procedure, rejects any part of the plea agreement or refuses to accept the guilty plea, The E.F. Hutton Group Inc., E.F. Hutton & Company Inc. and the United States will be relieved of any obligations of this Plea Agreement. It is further agreed that if the Court rejects this Plea Agreement, the United States may move to dismiss the charges without prejudice and Hutton will have no objection to such a dismissal nor any objection, on the basis of such dismissal of the charges, to the continuation of the Grand Jury's investigation or to the return of an indictment containing additional charges.

10. It is expressly understood and agreed that the provisions of paragraph "3(a)" in no way preclude the United States from prosecuting Hutton for any civil or criminal violation of Title 26 of the United States Code, whether or not arising out of the same facts and circumstances charged in the Information or referred to in paragraph "3(a)" above.

11. This Plea Agreement confirms the entire agreement between Hutton and the United States with respect to the aforesaid guilty plea and no other promises, representations or inducements have been made to Hutton or its attorneys with regard to such guilty plea.

DATED this 30th day of April, 1985

Stephen S. Trott
Assistant Attorney General
Criminal Division
U.S. Department of Justice

Robert W. Ogren

Robert W. Ogren
Chief, Fraud Section
U.S. Department of Justice
Washington, D.C. 20530

Albert R. Murray, Jr.
Assistant U.S. Attorney
Scranton, Pennsylvania

Peter B. Clark

Peter B. Clark
Trial Attorney
U.S. Department of Justice
Washington, D.C. 20530

The E.F. Hutton Group Inc.

By:

Thomas P. Lynch
President

E.F. Hutton & Company Inc.

By: Scott Pierce

Scott Pierce
President

Thomas F. Curnin

William G. Hundley

Attorneys for The E.F. Hutton
Group Inc. and E.F. Hutton
& Company Inc.

State of New York)
) ss.:
County of New York)

On this 30th day of April, 1985, before me personally came Scott Pierce, who executed the foregoing Plea Agreement on behalf of E.F. Hutton & Company Inc. and he being by me duly sworn did depose and say he is the President of E.F. Hutton & Company Inc. and has been duly and properly authorized and empowered to make, execute and deliver the foregoing Plea Agreement on behalf of E.F. Hutton & Company Inc.

BARBARA K. HUNT
Notary Public, State of New York
No. 1812690
Qualified in Westchester County
Commission Expires March 30, 1986

Notary Public

State of New York)
) ss.:
County of New York)

On this 30th day of April, 1985, before me personally came Thomas P. Lynch, who executed the foregoing Plea Agreement on behalf of The E.F. Hutton Group Inc. and he being by me duly sworn did depose and say he is the President of The E.F. Hutton Group Inc. and has been duly and properly authorized and empowered to make, execute and deliver the foregoing Plea Agreement on behalf of The E.F. Hutton Group Inc.

BARBARA K. HUNT
Notary Public, State of New York
No. 4812690
Qualified in Westchester County
Commission Expires March 30, 1985

Barbara K. Hunt
Notary Public

CERTIFIED COPY OF RESOLUTIONS

Authorization Re: Execution)
of Plea Agreement by)
E.F. Hutton & Company Inc.)

Upon the motion duly made, seconded and carried, the following resolutions were adopted:

RESOLVED, that this Corporation, expecting to be named as a defendant in a criminal action brought by the United States of America in the United States District Court for the Middle District of Pennsylvania, consents to a settlement of that action encompassing a plea of guilty to an information pursuant to a Plea Agreement in substantially the forms reviewed by this Board of Directors at this meeting; and

RESOLVED FURTHER, that Scott Pierce, President of this Corporation, Robert E. Witt, Executive Vice President, or any other senior officer, be, and they hereby are, authorized to execute such Plea Agreement and enter a plea of guilty to an Information on behalf of this Corporation substantially in such forms as reviewed by this Board of Directors at this meeting.

CERTIFICATION

I, THOMAS P. LYNCH, hereby certify that I am the duly elected Secretary of E.F. Hutton & Company Inc.; that the foregoing is a full, true and correct copy of resolutions duly adopted by the Board of Directors of said Corporation, at a meeting thereof duly held at the office of the Corporation, in New York, New York, on TUESDAY, the 30TH day of April, 1985, that the said resolutions have not been rescinded or revoked; and that the foregoing resolutions are not contrary to any provision in the Articles of Incorporation or By-Laws of E.F. Hutton & Company Inc.

IN WITNESS WHEREOF, I have hereunto signed my name as Secretary and affixed the Seal of said Corporation this 30TH day of April, 1985.

Secretary

CERTIFIED COPY OF RESOLUTIONS

Authorization Re: Execution)
of Plea Agreement by)
The E.F. Hutton Group Inc.)

Upon the motion duly made, seconded and carried, the following resolutions were adopted:

RESOLVED, that this Corporation, in connection with a criminal action brought by the United States of America in the United States District Court for the Middle District of Pennsylvania, consents to the execution of a Plea Agreement whereby E.F. Hutton Company Inc. shall plead guilty to an Information in substantially the forms reviewed by this Board of Directors at this meeting; and

RESOLVED FURTHER, that Thomas P. Lynch, President of this Corporation, be, and he hereby is, authorized to execute such Plea Agreement of The E.F. Hutton Group Inc. on behalf of this Corporation substantially in such form as reviewed by this Board of Directors at this meeting.

CERTIFICATION

I, Thomas P. Lynch, hereby certify that I am the duly elected Secretary of The E.F. Hutton Group Inc.; that the foregoing is a full, true and correct copy of resolutions duly adopted by the Board of Directors of said Corporation, at a meeting thereof duly held at the office of the Corporation, in New York, New York, on Tuesday, the 30TH day of April, 1985, that the said resolutions have not been rescinded or revoked; and that the foregoing resolutions are not contrary to any provision in the Articles of Incorporation or By-Laws of The E.F. Hutton Group Inc.

IN WITNESS WHEREOF, I have hereunto signed my name as Secretary and affixed the Seal of said Corporation this 30TH day of April, 1985.

Secretary

Exhibit B

Letter to all banks and financial institutions with which E.F. Hutton & Company Inc. maintained a deposit relationship during the period July 1, 1980 to December 31, 1982:

Pursuant to a plea agreement (the "Plea Agreement") filed in the United States District Court for the Middle District of Pennsylvania in United States v. E.F. Hutton & Company Inc., Criminal No. 85- (the "criminal proceeding"), E.F. Hutton & Company Inc. ("Hutton") hereby offers to make full restitution to any bank or financial institution (a "Bank") with which it maintained a deposit relationship during the period July 1, 1980 to December 31, 1982 (the "Period") for any net uncompensated interest losses incurred by said Bank as a result of Hutton's having drawn on uncollected funds without prior written agreement (the "Offer").

The purpose of the Offer is to reimburse the Bank for (1) unreimbursed service fees, (2) unreimbursed charges in respect of uses of uncollected funds, and (3) interest on the foregoing amounts. The Plea Agreement sets forth a procedure whereby Banks may request participation in the Offer, submit claims, and receive reimbursement. The Plea Agreement also sets forth the precise basis on which the amount of a claim is to be determined. In general, if the Bank maintained account analysis statements and contemporaneously supplied them to Hutton, the amount due will be that shown by the analyses. The following description of the Offer is qualified in its entirety by reference to the Plea Agreement, a copy of which is annexed hereto.

Procedure

1. A bank may request to participate in the Offer by sending a "Request for Participation" on the form annexed hereto to the Special Master appointed by the Court at the following address:

[Special Master's address]

A copy of the request must be sent to Hutton at the following address:

[Hutton's address]

A Request for Participation must be postmarked no later than 45 days from mailing, unless Hutton and the Bank shall agree to an extension of this period.

2. Please note that filing a Request for Participation constitutes a waiver of any other right to monetary recovery the filing Bank may have against Hutton for losses sustained during the Period. Once the Bank files a Request for Participation, its right to monetary recovery against Hutton for such losses is limited to such amounts as may be awarded pursuant to this Offer. A request for an extension of time in which to file a Request for Participation will not constitute a waiver of other rights; waiver will be effected only by filing a formal Request for Participation.

3. Within sixty (60) days after receiving the Bank's Request for Participation, Hutton will provide the Bank (at Hutton's expense) with copies of certain documents pertaining to its deposit activity at the Bank during the Period, to the extent such documents are in Hutton's possession. If you wish to receive these documents, please so indicate on the Request for Participation. The procedures for exchange of documents described in this and the following paragraphs will most likely not be necessary if account analysis statements were contemporaneously supplied to Hutton.

4. Within sixty (60) days after receiving these documents (or 120 days from the time you filed your Request for Participation, if you do not request documents) you must specify, to the extent you are able to do so, the amount of your claim for restitution on the form attached, unless an extension is obtained from Hutton.

5. Within thirty (30) days of filing your detailed claim, you must, if Hutton so requests, supply the documentation which you relied on to establish the amount of your claim. It is Hutton's desire to resolve claims as simply and expeditiously as possible. Hutton intends to pay all claims as soon as possible after receipt and review, although it reserves the right to request documentation with respect to any claim or claims submitted.

6. If, at this point, Hutton and the Bank do not agree on the amount of restitution to be paid, or if either party believes further documentation is required, the parties shall have ninety (90) days to conduct such discovery, if any, as they may require.

unless the Special Master deems it inappropriate. Thereafter, if the parties still do not agree as to the amount of restitution, the Special Master shall resolve the matter. The Special Master's determination shall be final, except that either party may request review by the Court on the ground that the Special Master's application of restitution formulas and procedures set forth in the Plea Agreement was manifestly irrational. Such review shall be sought within twenty (20) days of the Special Master's determination of a claim. Absent such review, Hutton will pay the amount awarded by the Special Master within thirty (30) days of the award.

Determining the Amount of Restitution

The amount of restitution will be determined pursuant to the formulas and procedures set forth in Exhibit C to the Plea Agreement. In general:

If you supplied monthly account analysis statements to your commercial depositors, including Hutton, during the Period, the principal amount of restitution due will be the analysis charges shown on the account analysis statements, giving Hutton due credit for (1) hard dollar payments it has already made to pay down such charges and (2) months in which the average collected balance remained positive after deducting balances required to cover fees. Otherwise it will be necessary to reconstruct Hutton's collected balance position with the Bank using the "Alternative Procedure" set forth in Exhibit C to the Plea Agreement. If it turns out to be necessary to apply the Alternative Procedure, Hutton will reimburse the Bank for its out-of-pocket costs reasonably incurred in connection with reconstructing the collected balance position in the account(s), up to a maximum of 10% of the amount awarded for claims under $10,000 and 5% of the award for awards larger than $10,000.

Regardless of how the monthly principal amounts are determined, they will bear simple interest at the broker call rate from the last day of the month to the day restitution is paid. For your convenience, a table of broker call rates applicable to each month is annexed hereto. A table of the federal funds rates for each day of the period, for use in case it is necessary to apply the Alternative Procedure, is annexed hereto.

Pursuant to the Plea Agreement, copies of the following documents are enclosed herewith:

1. The Information in United States v. E.F. Hutton Company Inc. Criminal No. 85- (M.D., Pennsylvania) (the "criminal proceeding");

2. The Plea Agreement in the criminal proceeding;

3. The Complaint for Permanent Injunction and Ancillary Relief in United States v. The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc., Criminal No. 85- (M.D., Pennsylvania) (the "civil proceeding").

4. Consent and Undertaking of The E.F. Hutton Group Inc. and E.F. Hutton & Company Inc. in the civil proceeding; and

5. The Final Judgment of Permanent Injunction in the civil proceeding.

If you have any questions concerning the operation of this offer, please write to Hutton at [address].

E.F. Hutton & Company Inc.

By: ______________________________

Exhibit B-1

REQUEST FOR PARTICIPATION

To [Special Master] and E.F. Hutton & Company Inc.,
at the addresses specified in Exhibit B.

______________________________(the "Bank") hereby requests participation in the restitution program established pursuant to the Plea Agreement in United States v. E.F. Hutton & Company Inc., Cr. No. 85- (M.D., Pennsylvania). The Bank understands and agrees that by filing this Request for Participation it is waiving any other right to monetary recovery it may have against The E.F. Hutton Group Inc., E.F. Hutton & Company Inc., and their respective past and present officers, directors, agents, employees, successors, assigns and subsidiaries for losses arising out of any deposit relationship that existed between the Bank and E.F. Hutton & Company Inc. ("Hutton") during the period July 1, 1980 to December 31, 1982 (the "Period").

[Name and address of Bank]

By: ______________________________
[Name and Title]

ATTACHMENT TO REQUEST FOR PARTICIPATION

Documents Requested by Hutton

Did the Bank supply contemporaneous account analysis statements to Hutton during the period? If so, attaching them to this Request (or sending them on shortly) will speed processing of your claim and may obviate the need for additional documentation.

Documents Requested by Bank

The Bank hereby requests copies of the following Hutton documents pertaining to Hutton's deposit accounts at the Bank (check categories desired):

__________ Hutton general ledger ("checkbook")

__________ Bank statements

__________ Hutton cash receipt and disbursement blotters (which frequently, but not always, contain routing and transit numbers of deposited items)

__________ Hutton depository transfer checks and deposited items.

NOTE: If blotters are requested, it will be necessary to redact customer-identifying information from them, which is a time consuming process. Accordingly, please do not request copies of blotters unless you believe it will be necessary to follow the Alternative Procedure set forth in Exhibit C as the Plea Agreement, since a request for blotters will delay processing of your claim.

STATE OF)
: ss.:
COUNTY OF)

On the day of , nineteen hundred and before me personally came , to me known, being by me duly sworn, did depose and say that (s)he is the of , the Bank described in the foregoing instrument; that (s)he was authorized to execute said instrument on behalf of said Bank; and that (s)he did execute said instrument pursuant to such authorization.

____
Notary Public

Exhibit B-2

CLAIM FOR RESTITUTION

To [Special Master] and E. F. Hutton & Company Inc.:

______________ (the "Bank") hereby claims restitution from E. F. Hutton & Company Inc. ("Hutton") in the following amount: ____

This claim comprises a principal amount of $________ plus interest of $_______ to the date of this claim. The Bank further claims interest on the principal amount at the broker call rate from the date of this claim to the date of payment.

The claim consists of the following monthly amounts of principal and interest (you must fill in an amount for each month and indicate whether it is in favor of Hutton or the Bank):

Month	Principal Amount	Interest to Date
July 1980	______________	______________
August 1980	______________	______________
September 1980	______________	______________
October 1980	______________	______________
November 1980	______________	______________
December 1980	______________	______________
January 1981	______________	______________
February 1981	______________	______________
March 1981	______________	______________

Month	Principal Amount	Interest to Date
April 1981		
May 1981		
June 1981		
July 1981		
August 1981		
September 1981		
October 1981		
November 1981		
December 1981		
January 1982		
February 1982		
March 1982		
April 1982		
May 1982		
June 1982		
July 1982		
August 1982		
September 1982		
October 1982		
November 1982		
December 1982		
TOTAL		

Please provide the following information:

1. As to what, if any, portion of the Period did the bank determine the monthly principal amounts set forth above by reference to account analysis statements? ______________

By reference to the Alternative Procedure? ______________

2. If any reference was made to the Alternative Procedure, does the Bank have in its possession its availability schedules (if any) for the portion of the Period for which such reference was made? __________ Does it have the availability schedules for any of its correspondent banks through which Hutton deposited items may have been cleared? ____________________

Which banks? ____

Does it have the availability schedules for any Federal Reserve Bank or Pegional Check Processing Center through which Hutton deposited items may have been cleared? ____________________

3. Does the Bank have in its possession any of its schedules(s) of service fees in effect during the Period ? __________ Which ones? ______________________________

[Name and address of Bank]

By: ______________________
[Name and Title]

STATE OF)
: ss.:
COUNTY OF)

On the day of , nineteen hundred and before me personally came , to me known, being by me duly sworn, did depose and say that (s)he is the of , the Bank described in the foregoing instrument; that (s)he was authorized to execute said instrument on behalf of said Bank; and that (s)he did execute said instrument pursuant to such authorization.

Notary Public

Exhibit C

Restitution pursuant to paragraph "4" of the Plea Agreement shall be calculated only pursuant to the following formulas and procedures. These formulas and procedures determine the extent, if any, of out-of-pocket losses suffered by a Bank as a result of its deposit relationship with Hutton Company during the Period. These losses shall include (1) unreimbursed service fees, (2) unreimbursed charges in respect of uses of uncollected funds, and (3) interest on the foregoing amounts.

1. The Aggregate Restitutionary Amount to be paid to a Bank shall be the single dollar amount obtained by adding together all the Monthly Increments to the Restitutionary Amount, positive or negative, for all deposit accounts maintained by Hutton Company at the Bank during the Period. If this single dollar amount is positive, the amount shall be paid to the Bank; if it is negative,,it shall be ignored.

2. The Monthly Increment to the Restitutionary Amount for each month is the Monthly Analysis Charge for that month plus Simple Interest at the Broker Call Rate on that amount calculated monthly, for each month to the date of payment of restitution. The Monthly Analysis Charge for a given month consists of the Bank's service fees actually charged for account activity during that month, plus imputed interest charges (or credits) for use of uncollected funds (or excess collected balances.) The Monthly Analysis Charge is expressed so that positive amounts are in

favor of the Bank and negative amounts are in favor of Hutton Company. It is computed pursuant to paragraph "4" below, if applicable, and otherwise pursuant to the Alternative Procedure set forth herein.

3. Simple Interest at the Broker Call Rate on a principal amount shall be calculated by determining, for each month, the average daily call rate for the month, and multiplying the principal amount by 1/12 of that rate. Said average daily call rate shall be calculated by adding together the broker call rate (as published in The Wall Street Journal and expressed as an annual percentage rate) for each day of the month (the rate for a non-banking day being the rate for the immediately preceding banking day) and dividing the result by the number of days in the month.

4. To the extent that a Bank provided its commercial customers,.including Hutton Company, with monthly account analysis statements during the Period, the Monthly Analysis Charge for each month during the Period for which account analysis statements were so provided shall be the analysis charge shown in the account analysis statement for that month, less any amounts paid by Hutton Company to the Bank during that month on account of any service fees or analysis charges incurred during the Period. If no such contemporaneous account analysis statements exists, the Monthly Analysis Charge shall be computed pursuant to the Alternative Procedure set forth below.

5. To the extent that Hutton Company claims it made payments (whether in the form of hard dollars or increased balances) to a Bank after the close of the Period on account of charges incurred during the Period, Hutton Company has the burden of demonstrating the amount of the payment and the portion of the Period to which it applies. Upon satisfying this burden, the Aggregate Restitutionary Amount for that Bank shall be reduced (but not below zero) by the amount of the payment plus Simple Interest at the Broker Call Rate on the payment, computed from the end of the month in which the payment was made to the date on which restitution was paid.

6. To the extent that Hutton Company contends that any payment to a Bank (whether during or after the Period) operated as an accord and satisfaction, Hutton Company bears the burden of proving such contention. Upon Hutton Company's satisfying this burden, the accord and satisfaction will be given effect according to its terms.

7. To the extent that Hutton Company contends that its deposit relationship with a Bank was part of a larger relationship, i.e., in addition to the deposit relationship, with the Bank pursuant to which it was agreed or understood that Hutton Company would not be charged the Bank's usual service fees or analysis charges, Hutton Company bears the burden of proving such relationship or understanding, which, if proved, will be given effect according to its terms.

Alternative Procedure

In the event that monthly account analysis statements with respect to the Hutton Company accounts at issue, were not contemporaneously supplied to Hutton Company or if the relevant statements no longer exist, the Monthly Analysis Charge component of the Monthly Increment to the Restitutionary Amount (paragraph "2" above) shall not be calculated from the analysis statements but shall instead be calculated as set forth in this Alternative Procedure.

1. The Monthly Analysis Charge for a given month is the sum of the Monthly Balance Charge for that month and any service or other fees actually contemporaneously charged against Hutton, less any amounts actually paid by Hutton Company to the Bank during that month on account of service fees or analysis charges, except to the extent that such payments were on account of fees or charges incurred prior to the beginning of the Period.

2. The Monthly Balance Charge for a given month is calculated by adding together the Imputed Balance Charges for each calendar day of the month.

3. The Imputed Balance Charge for a banking day is calculated by multiplying together three factors, to wit, (1) the negative of Today's Collected Balance, (2) the Reserve Multiple, and (3) the Federal Funds Rate for the day. The Imputed Balance Charge for a non-banking day is the Imputed Balance Charge for the immediately preceding banking day. The Imputed Balance Charge may be a positive or negative number. A positive number reflects an amount in favor of the Bank.

4. The Federal Funds Rate for a given day is the average of that day's closing bid and asked rates for interbank overnight sales of federal funds expressed as a daily percentage rate, as reported by The Wall Street Journal.

5. The Reserve Multiple for a given Bank on a given day is the number obtained by subtracting from unity the Bank's Regulation D reserve requirement for that day, expressed as a decimal.

6. Today's Collected Balance may be positive or negative. It is Today's Bank Ledger Balance less Today's Float.

7. (a) Today's Bank Ledger Balance is Yesterday's Bank Ledger Balance, plus the aggregate face value of items deposited today, plus the aggregate face value of credit memoranda credited today (including, without limitation, incoming wire transfers, loan proceeds, and reversals of charges or items previously debited), less the aggregate face value of items paid today, less debit memoranda debited today (including, without limitation, service fees actually debited and outgoing wire transfers). Today's Bank Ledger Balance may be either positive or negative.

(b) Where contemporaneous bank statements are available, Today's Bank Ledger Balance for a given day is presumptively that day's closing bank balance as shown on the bank statement, subject to the right of Hutton Company or the Bank to demonstrate a different amount.

8. Today's Float is the sum of Today's One-Day Float and Today's Two-Day Float.

9. Today's Two-Day Float is the aggregate face value Today's Two-Day Items.

10. Today's One-Day Float is the sum of (1) the aggreg face value of Today's One-Day Items and (2) Yesterday's Two- Float.

11. A Zero-Day Item is (1) cash; (2) an "on us" check; (3) an incoming wire transfer; (4) any other cash item (inc without limitation, loan proceeds and credit for sale or ot transfer of securities) that is not a cash item in the proc collection within the meaning of 12 C.F.R. §204.3(f) as of close of the bank's books on the day the item is deposited credited.

12. A One-Day Item is a cash item that is not a Zero-D Item and is not a cash item in the process of collection as the close of the bank's books on the banking day following day of deposit.

13. A Two-Day Item is a cash item that is not a Zero-D Item or a One-Day Item. If the Bank demonstrates an item o class of items remained cash items in the process of collec for Regulation D purposes for longer than two banking days, items shall be included in Today's Float for as many days a were actually treated as cash items in the process of colle on the bank's books.

14. "Yesterday" means the preceding banking day.

15. Determination of whether a deposited item is a Zer Item, a One-Day Item, or a Two-Day Item shall be made accor to the first of the following procedures that applies to th

item:

(a) If the Bank had a published availability schedule for commercial customers in effect at the time the item was deposited, then the availability schedule controls.

(b) Otherwise, if the item is a check as to which the drawer is a person or entity other than Hutton Company, it is a One-Day Item.

(c) Otherwise, if the item is a Branch Reimbursement Check, it is a One-Day Item or a Two-Day Item depending on whether it actually cleared within one banking day or within two or more banking days.

(d) Otherwise, if the item is a check drawn on a bank within the same Federal Reserve District or within 100 air miles of the depository Bank, it is a One-Day Item.

(e) Otherwise, it is a Two-Day Item.

As to any item, Hutton Company has the burden of proving shorter availability (e.g., that a supposed Two-Day Item was in fact a One-Day Item) than that determined by "(a)" through "(e)" above, and the Bank has the burden of proving longer availability.

In the event that it becomes necessary to invoke this Alternative Procedure with respect to a particular Bank, Hutton Company shall reimburse that Bank for the Bank's actual out-of-pocket expenses reasonably incurred in developing and analyzing the materials required by this Alternative Procedure. Where the amount of restitution awarded to the Bank hereunder shall be less than $10,000, such reimbursement shall not exceed 10% of the amount of restitution awarded. Where the amount of restitution awarded shall equal or exceed $10,000, such reimbursement shall not exceed 5% of the amount of restitution awarded.

TESTIMONY

OF

STEPHEN S. TROTT
ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

BEFORE

THE

SUBCOMMITTEE ON CRIME
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

CONCERNING

CORPORATE CRIME

ON

JUNE 5, 1985

I appreciate this opportunity to discuss with you the subject of economic crime enforcement and to give you our perspective on the E.F. Hutton prosecution.

A month ago, in a major speech in Boston, the Attorney General reaffirmed the commitment of the Department of Justice to a vigorous federal white collar crime enforcement program. The Attorney General's statement could not have been more timely. It occurred in the midst of series of landmark events in white collar crime enforcement and at a time when the importance of effective federal white collar crime enforcement is more critical than ever.

I am particularly pleased to have the opportunity to restate for this Subcommittee our commitment to a strong white collar crime enforcement effort.

Our nation faces a white collar crime problem that infects all aspects of our economy and lives. Viewed in terms of dollar impact, the losses caused by white collar offenses are staggering. White collar crimes cost Americans hundreds of billions of dollars every year.

Over $100 million is lost annually through high pressure "boiler room" operations fraudulently selling commodities such as precious metals by telephone. Over one-half billion dollars were lost in the past five years in real estate investment schemes in California alone. Hundreds of millions of dollars have been lost by tens of thousands of investors who have been victimized by fraudulent financial service brokers operating in Florida, California, Utah, Ohio, and New Hampshire. Approximately $80 million was lost in the J. David investment fraud scheme on the West Coast -- a scheme that culminated two months ago in a financier's entry of a plea of guilty. Almost $700 million in losses resulted from a Tennessee bank fraud scheme that concluded with Jake Butcher's plea of guilty several weeks ago. Just this week Butcher received a sentence of 20 years in prison.

White collar crime seriously harms the well-being of our nation. It siphons billions of dollars a year from our economy. It steals the life savings of investors. It adds to the costs of goods and services, and diminishes the revenues otherwise available to the federal and state treasuries. It aggravates the financial burdens of all Americans, who are the indirect victims of fraudulent offenses as well as the direct ones.

The consequences of white collar crime are, however direct and visible. It causes banks to fail. In fact, fraud is a factor in over half of the bank failures in the past five years. White collar crime adds hundreds of millions, if not billions, to the cost of military purchases. It creates defective weapons and military supplies that undermine our ability to defend our nation. It destroys the public's faith in our federal programs such as Medicare and Food Stamps.

Because the economic crime problem is so widespread and the cases themselves so complex and resource intensive, it is vitally important that the federal enforcement effort not be encumbered by antiquated laws, limited techniques, or wasted efforts. The white collar crime provisions of the Comprehensive Crime Control Act enacted by Congress in 1984 were particularly welcomed. That Act toughened the penalties for Title 31 currency act violations. It enacted a broad bank fraud statute. It created an injunctive remedy to respond to the problem of ongoing criminal conduct. The fine provisions of the Fine Enforcement Act of 1984 will substantially increase the cost of committing crime for the white collar criminal. Maximum fines per violation are now $250,000 for individuals and $500,000 for corporations. Using these weapons we can seek to strip the white collar criminals -- both individuals and corporations -- of every last penny of their ill-gotten gains. Considerable progress has been made. But further progress is needed. In the near future we will submit to the Congress a comprehensive legislative package that will improve our ability to respond to defense procurement frauds. In addition, we will propose legislation that will enhance our ability to prosecute professional money launderers and will further enhance our ability to handle bank fraud prosecutions. We hope you will join us and vigorously support these legislative initiatives.

The key to any federal white collar crime enforcement effort is to use our resources as efficiently and effectively as possible. That requires selecting our priorities with care, developing close cooperation among all elements of law enforcement, crafting creative strategies and carefully utilizing our resources in the most effective manner.

In 1983, Attorney General Smith created the Economic Crime Council to serve as an advisory body on white collar crime enforcement policy within the Department of Justice. The Council is chaired by the Deputy Attorney General. Its membership includes 21 United States Attorneys and officials of the Criminal Division and the FBI, and, beginning this year, the Antitrust, Civil and Tax divisions of Department of Justice. One of the Council's principal roles has been to aid in developing white collar crime priorities. The Council, working in conjunction with the Criminal Division, has defined our law enforcement priorities sharply and clearly. We are concerned about areas that affect our national defense, our banking system, the taxpayer and the investment public. The six principal priority areas are defense procurement frauds, frauds against banks and savings and loans, investment "boiler room" frauds, money laundering, various types of securities frauds, and health care frauds. We must strike decisively and effectively against such economic crimes because they corrupt the economic integrity of our society and its institutions.

One priority area of prosecution -- bank fraud -- is of particular relevance to today's hearings. Fraud against banks is a major concern of the Department of Justice for one simple reason. Over one half of the bank failures in the United States in the last five years were either caused by or related to criminal conduct. That fact is deeply disturbing. The nation's economic health turns on stability in its banking institutions. With this objective in mind, former Attorney General Smith and the heads of the bank regulatory agencies created a task force last December to revise the referral mechanism that brings bank fraud cases into the criminal justice system and to develop improved methods for handling major bank fraud cases. The result of that effort, announced by Attorney General Meese two months ago, is an interagency agreement which has already improved our handling of significant bank fraud cases. One specific objective of the task force -- and one relevant to these hearings -- was to improve the enforcement mechanism so that action could be taken to prevent banks from failing.

Before turning to the specific facts of the Hutton case, I want to address briefly two other points.

We believe there are a number of ingredients to a successful criminal enforcement effort. Certainly the dominant one is the prosecution, conviction and imprisonment of all individuals who perpetrate crime. But that traditional solution, in many instances, does not go far enough. It does not take into account the need to prevent crimes before they occur, or to bring cases which by their scope, and the swiftness by which they become final, provide clear, dramatic warning that specific conduct will be prosecuted. It also ignores the need, in the very special setting of offenses committed to benefit corporations, to impose direct and substantial sanctions upon the corporation, in addition to those imposed on the individuals, and to force the corporation to adopt internal control mechanisms that will prevent future criminal conduct and substantially alter the ways in which the corporation conducts its affairs.

Our white collar crime enforcement program is a varied and successful one. Statistics tell us we are prosecuting more economic crime now than ever. White collar crime prosecutions have risen as a percentage of total federal prosecutions from 8% to 1970, to 20% in 1980 and to 24% in 1983 and 1984. Numbers, however, do not begin to tell the full story. Certainly the cases are more significant than ever. Within just the last 70 days our national effort includes these remarkable events:

- General Electric Company was indicted and convicted in Philadelphia charges of defrauding the Defense Department and was simultaneously suspended from doing business with the United States Government. Two individual employees of General Electric were also indicted for perjury and obstruction of justice with respect to the grand jury investigation in the case.
- Jake Butcher entered guilty pleas to several indictments and has been sentenced to 20 years in prison for looting a series of banks in Tennessee and Kentucky. Two of his accomplices have also been convicted and await sentencing.
- Paul Thayer, former Deputy Secretary of Defense, and Dallas stockbroker Billy Bob Harris were sentenced in Washington, D.C. to four years in prison for obstruction of justice in connection with their roles in a million dollar insider stock trading scheme.

- a 35-year prison term was imposed on Fred Soudan in Houston, Texas, for his role in master minding the largest maritime fraud in history -- the infamous sinking of the super tanker "Salem" off the west coast of Africa.
- the Attorney General announced a comprehensive overhaul of and improvements in the mechanism for referring bank fraud cases for criminal prosecution.
- six defendants were convicted in Texas of Foreign Corrupt Practices Act violations in the $10 million Pemex/Crawford foreign bribery scheme and are awaiting sentencing.
- the conviction of J. David Dominelli in San Diego on mail fraud charges in connection with the J. David Company an investment scheme that defrauded 1,500 people out of $200 million.
- conviction of the LeBlanc brothers in Detroit for an investment scheme in which 800 investors lost $10.5 million.
- Indictment in Florida of convicted con-man and boiler-room operator Jack Rose in a scheme that bilked 1,200 investors out of $12 million in a precious metals scam.

- Conviction of E.F. Hutton and Company, Inc. of 2,000 counts of mail and wire fraud in a nationwide check-kiting scheme and unprecedented civil injunctive relief.

I seriously doubt whether there was ever a collection of more significant white collar crime cases resolved in such a short period of time. And I can promise you more are to come in the months ahead, most in our national priority areas.

We are proud of this record and, with respect to the subject matter of today's hearing, we are proud of the results achieved in E.F. Hutton prosecution. By any standard, the Hutton case is a landmark and its law enforcement accomplishments are noteworthy.

The facts of the Hutton case are enormously complex as you will learn in our detailed briefing. Most public comment on the results in the case has been based both on a serious misunderstanding of the unusual factual and legal setting of the case and a failure to appreciate the litigation risks faced in the prosecution. We have heard no criticism from regulators, bankers, lawyers and responsible corporate managers who have taken the time to study what was done in the Hutton case. The message of the Hutton case has been read loud and clear by those immediately affected by it. To aid your understanding, I am appending to this statement a summary of the Hutton case, which includes a description of its legal setting, the litigation risks we confronted and the relief we obtained.

The Hutton prosecution is without precedent in the federal system. Some of the practices embraced by our enforcement action were probably legal until enactment of the bank fraud statute last October. Nevertheless, they constituted serious abuses that threatened to inflict significant losses on banks. The perpetrators did not believe they were committing a crime, although in fact their acts now are clearly illegal and many of them were at the time. The investigation covered 3 years and ultimately involved the analysis of 7,000,000 million documents. On top of these difficulties, we recognized that many of Hutton's most serious cash management abuses could not be reached by a conventional criminal prosecution.

Our prosecutors had to choose. The first option: a conventional prosecution of Hutton and two mid level individuals, would have been costly, inefficient, had a questionable prospect of success and could not reach the most widespread abuses of Hutton and the rest of the money management community. The second option: a comprehensive settlement that we judged would address most directly the serious problem of widespread money management abuses.

For what amounted to deceiving banks into giving it interest-free unsecured short-term loans, Hutton was required to plead guilty -- not nolo contendre but guilty -- to an unprecedented 2,000 felony counts of intentional mail and wire fraud. It was fined $2,000,000, the maximum the law allows for this unparalleled number of counts, and a sum which makes it the steepest fine in the history of our white collar enforcement effort. Hutton was also required to pay the Government $750,000 to cover the costs of the investigation. Those costs are ordinarily not recoverable, even with a jury verdict of guilty. Additionally, the new injunctive provision of 18 U.S.C. §1345 was used for the first time since its enactment by Congress in October 1984 to enjoin all of Hutton's cash management abuses, not just those precisely identified in the criminal information, many of which were not criminal prior to enactment of the Comprehensive Crime Contract Act.

The Department of Justice also required that Hutton immediately make full and complete restitution, with interest, to each and every one of the bank victims without regard to the federal district in which they reside. Rarely is there a criminal fraud case where this much immediate benefit flows to victims. Usually victims interests are handled as an afterthought. It is incorrect to assume or infer that restitution is limited to the $8,000,000 Hutton has reserved for this purpose. Hutton is obligated to pay back the total amount obtained fraudulently, plus interest, whatever that may be. In sum, this is the most comprehensive program of restitution ever developed in a federal criminal case.

As I noted before, one of the important priorities of the Department of Justice is the protection of the banking industry itself from fraudulent schemes. Predatory money-management practices and cash concentration systems have become, in the hands of a few, a science that can threaten our banking institutions. Professionals working in that specialty have associations which sponsor conferences, exchange information, and publish articles. Their sophisticated activities and techniques have a definite impact on our nation's banks and financial institutions of which few people are aware. The Federal Reserve has been highly critical of "float creating" and "float-playing games," of which Hutton's was an extreme example, and we are in agreement with that concern. Hutton's practices had tremendous potential for harming banks, particularly the smaller, more vulnerable ones. The injunction covers conduct that we were unable to include in our criminal charging document and thus we achieved important multiple objectives in a single decisive stroke. This conviction and injunction sent a clear message to professional money managers around the country. There should be no doubt that these kinds of abuses are criminal and will be prosecuted.

The public must have faith in the stability of our financial institutions, and they must have it today, not tomorrow. Naming numerous small banks victimized by Hutton in an unresolved indictment and alleging widespread fraud and losses had the capacity to undercut public confidence in those banks. If that route had been chosen and runs on deposits had developed, the situation would have been highly undesirable. One only has to look to the recent problems in Ohio and Maryland to see how fragile public confidence can be when it appears to depositors that the financial institution to whom their money has been entrusted is on shaky ground. The plea of guilty, the injunction plus complete restitution without a risky, costly, and lengthy trial achieved our objectives, now, not two or three years from now. The word is out. The cloud is gone. The matter has been favorably resolved without the uncertainties and vagaries of the protracted trial we estimate would have involved some 300 witnesses and several hundred thousand documents.

Several aspects of the case deserve mention. As we have described more fully in the case summary submitted with this testimony, check kiting became difficult to prosecute as a result of the Supreme Court's decision in United States v. Williams, 458 U.S. 279 (1982). The theory prosecutors traditionally employed was that an overdraft check constituted an "overvalued security" or a "false statement" to the bank which honored it. The Supreme Court rejecting that theory held that a check made no representation as to the state of the bank account on which it was drawn, and, moreover, was not an overvalued security.

As you know, we recommended remedial legislation to the Congress to cure this problem and that provision, 18 U.S.C. §1344, was adopted as part of the Comprehensive Crime Control Act of 1984.

Before passage of §1344, the principal alternative to §1014 as a check kite prosecutive vehicle was mail or wire fraud in the limited cases where those statutes applied. In the Third Circuit, however, Williams took its toll on the "mail fraud/wire fraud" approach to prosecuting check kites. In United States v. Frankel, 721 F.2d 917 (3rd Cir. 1983), the Court relied on Williams to conclude that a check kite could not be charged under the "false pretenses, representations and promises" clause of 18 U.S.C. §1341 because a check was not a representation. Frankel left open the possibility of a prosecution under the "scheme to defraud" clause, but failed to explain how that could be done.

The net effect of the Williams and Frankel decisions was to circumscribe our ability to prosecute check kites. Finding a theory that would not lead to a dismissal under either Williams or Frankel was not simple. The theory we adopted, and which is reflected in the Hutton criminal charges, focused on a misrepresentation of Hutton's relationship with its banks: Hutton held itself out as creating depository accounts to handle only customer money where in fact the accounts were used to process huge overdraft checks. This is a rather unconventional and untested prosecutive approach to check kiting and turned completely on our ability to establish persuasively that the depository accounts were intended for a highly specific limited use. Obviously, this creative circumvention of Williams and Frankel would have been tested vigorously pre-trial and post-conviction.

The second legal defense we expected was a claim of good faith. Hutton alleged it was guilty merely of aggressive money management. In fact, Hutton insisted that they had done nothing wrong and had only attempted to "recapture float" that did not belong to the banks. Hutton insisted that its practices were no different than those of other companies.

The third possible legal attack on our case, available to the individuals who might have been charged, was the simple claim that each was acting pursuant to corporate policy and, because Hutton had the means to pay the banks, the requisite mens rea or intent to defraud was absent.

As to the individuals primarily responsible in a criminal sense for this activity, there were essentially two key people. Beyond that they cannot be identified -- nor can the evidence against them be detailed or characterized -- because of Rule 6(e) of the Federal Rules of Criminal Procedure that requires continuing secrecy with respect to matters occurring before a grand jury. However, neither individual was a high-level executive of the company.

In assessing the manner in which this case ought to be handled, our prosecutors started from the proposition that individuals ought to be held personally responsible for their criminal misconduct. This is our normal policy from which we deviate only when faced with a compelling reason to make an exception. Pursuing at trial the known individual authors of these abuses would have had some merit, but not at the expense of foregoing the opportunity to dictate the key terms of, and seize without delay, this extraordinary settlement. To prosecute the individuals would have required us to drop the settlement in favor of a protracted court fight that would have taken years to complete. That was the choice. Our career prosecutors opted for the numerous overwhelming benefits of the immediate solution, and

we find their judgment to be absolutely sound and above approach. The benefits derived from the Hutton plea were so substantial that they clearly warranted an exception to our policy of affixing personal responsibility for wrongdoing.

Summary of the E.F. Hutton & Company Inc. Investigation and Prosecution

In December 1981, a check kite being operated by a number of E.F. Hutton & Company Inc. ("Hutton") branches collapsed when an $8,100,000 check was bounced by the Genessee Country Bank of Batavia, New York. This event triggered a joint inquiry by the New York State Banking Commission and the Federal Reserve Bank of New York. Ultimately an FDIC examiner learned of the incident and, because the kite involved checks drawn on the United Penn Bank in Wilkes-Barre, Pennsylvania, the examiner referred the matter in March 1982 to the United States Postal Inspection Service in Scranton, Pennsylvania, and to the United States Attorney in Scranton. Assistant United States Attorney Albert R. Murray, Jr. of the Middle District of Pennsylvania was assigned to the case.

After reviewing the allegations and events surrounding the Genessee/United Penn kite, Assistant United States Attorney Murray opened a grand jury investigation. [1]

Staffing and Scope of the Investigation

The investigation commenced in April 1982 and continued until May 1985. Assistant United States Attorney Murray believed it possible that the Genessee kite was evidence of more wide spread abuses by Hutton. The investigation was structured to test that theory. The investigation was staffed by Assistant United States Attorney Murray and a Postal Inspection team headed by Postal Inspector John Holland of the Harrisburg office. Assistant United States Murray, who had previously been in private practice, became an Assistant United States Attorney in January 1980. Mr. Holland has been a postal inspector for 14 years. Peter B. Clark, an experienced Criminal Division Fraud Section attorney, who had previously been in private practice and had been a Special Counsel in the Enforcement Division of the Securities and Exchange Commission, joined the prosecutive team in August 1984.

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[1] During the grand jury investigation commenced several months before the Supreme Court decided United States v. Williams, 458 U.S. 279 (1982) which drastically curtailed federal prosecutions of check kiting. See discussion *infra* under "Legal Theory and Problems."

The site of the investigation, for logistical and tactical reasons, was Harrisburg, Pennsylvania. One key reason was to limit the possibility of publicity. The grand juries that investigated the Hutton matter were located in Harrisburg.

During the investigation numerous witnesses testified before the grand jury, many on more than one occasion. Many witnesses insisted upon use immunity protection, which was supplied in the form of a letter in lieu of statutory §6001 immunity. In each instance, proffers were received in advance of the immunity grant. No immunized witness was a target of the grand jury investigation.

Except for those who invoked the Fifth Amendment and refused to testify, all relevant Hutton headquarters personnel were interviewed.

John S.R. Shad, Securities and Exchange Commission Chairman, was, until 1980, vice-chairman of the board of Hutton. There was no evidence nor any allegation that Mr. Shad had participated in the check scheme or indeed knew about it. Mr. Shad was interviewed and we concluded that he had no connection with the scheme.

During the investigation over 300 subpoenas were issued. The number of documents obtained by subpoena was approximately 7,000,000. One of the principal initial tasks was to organize the subpoenaed documents pursuant to a system that permitted orderly retrieval. The documents were physically maintained at the main postal facility in Harrisburg. Because their volume exceeded available space in the Postal Inspection Service offices, the records were maintained in a large, specially constructed, locked area of the post office basement.

A major task of the investigation was to acquire a working knowledge of Hutton's cash concentration system and the Federal Reserve and bank check collection systems. A substantial portion of the investigative effort during the first 18 months was devoted to accomplishing these objectives.

A further point should be noted. The original investigative focus of the case was Hutton activity occurring within the Middle District of Pennsylvania. Until 1984, the investigation did not focus on practices and specific abuses that occurred nationally. The narrow geographic focus of the first half of the investigation was dictated by the original allegations and the venue limitations of federal criminal jurisdiction.

Once it became clear that Hutton's activities were not mere isolated episodes but appeared to reflect a widespread corporate practice, Assistant United States Attorney Murray's objective was to place responsibility for this practice at the highest possible level within Hutton. As a general rule, this strategy led to the pattern of interviewing branch personnel (most of whom sought and obtained immunity), and subsequently certain regional personnel, in an effort to build a case against the members of management responsible for devising and implementing Hutton cash concentration policies. In that regard, it is important to note that vast majority of those who sought and received "immunity" were not criminally culpable in the scheme. Informal immunity is often sought by attorneys representing non-culpable persons in an investigation.

What Hutton Did

In the late 1970's, Hutton had in place a cash concentration or "draw down" system by which the funds collected from its customers at over 400 branch offices throughout the country were moved to bank accounts in New York and Los Angeles, where the funds were available for Hutton's business uses. These customer funds, which amounted to between $200 and $400 million each business day, were first deposited in local bank accounts maintained by each Hutton branch. Hutton advised its branch depository banks were advised by Hutton that these accounts would be used to deposit funds received from the firm's local customers and to transfer these funds to Hutton's regional and prime concentration bank accounts. The local depository banks granted Hutton "next-day" availability on these deposits, that is, on the business day following the deposit of local customers' checks, Hutton would be permitted to withdraw funds in the amount of the deposited items. The branch depository banks believed Hutton would be depositing checks Hutton had received from local Hutton customers, and that the banks would be collecting them on the following business day. Therefore, the banks assumed they would be in a collected position by the time Hutton withdrew the funds.

While Hutton could have transferred its collected or available funds from its hundreds of branch depository accounts to its prime concentration accounts by bank wire transfers, this procedure would have required over 150,000 wire transfers each year at an estimated cost in excess of $1 million. Instead, Hutton "drew down" its branch depository accounts by means of a system which, each business day, required (1) Hutton branch office personnel to determine the collected balance in each branch depository account and telephone that information to the branch's regional office; (2) Hutton regional office personnel to draw checks manually on each branch depository account in their region, deposit the checks in a regional depository account and telephone that information to the firm's cash desk in New York City; and (3) Hutton main office personnel to draw checks on each regional depository account or otherwise direct the transfer of funds from the regional depository accounts to the firm's prime concentration accounts in New York City or Los Angeles. This system, so long as only collected funds were drawn down, was legal.

Hutton's illegal conduct was a series of variations on its established "draw down" system. Hutton modified the legal draw down procedure to withdraw funds from its branch depository accounts in arbitrary amounts well in excess of either customer receipts or the collected balances in those accounts. To do this, Hutton had to "cover" or otherwise conceal the overdrafts it created by depositing into those accounts checks drawn upon other Hutton accounts. These overdrafts, in turn, were hidden from the depository banks by covering checks drafted by Hutton branch personnel and deposited into bank accounts. These checks, available in each Hutton branch office, were drawn upon "zero balance" accounts at one of two New York City banks. By agreement with these banks, Hutton was required to keep no minimum balance but rather was permitted to wire transfer into the accounts, on a daily basis, sufficient funds to cover all checks presented for collection that day.

Furthermore, the covering "zero balance" checks, unlike the local Hutton customer checks which would be collected within one day, took a minimum of two days to clear. Nevertheless, branch depository banks, not realizing that these were not deposits of local customer funds, permitted Hutton to have "next-day" availability on these items as well. Hutton thus exploited the customary bank practice of examining only the ledger balance to determine whether an overdraft exists in an account. As Hutton's branch office personnel were continually depositing Hutton's own checks into the depository accounts, these deposits appeared on the bank's ledgers to balance Hutton's withdrawals. In actuality, because of the minimum one extra day in the collection of a Hutton "zero balance" check, the account was overdrafted for an equivalent period.

Overdrafting was accomplished in a variety of ways, the most blatant being the simple addition of a "zero" to the branch depository transfer check. In this manner, a $100,000 deposit of customers' funds would be arbitrarily increased to $1 million as it was drawn down and a Hutton "zero balance" check in the amount of $900,000 would be deposited in the account to cover the overdraft.

Two specific instances of arbitrary overdrafting, drawn from the Rule 11 proceeding, show dramatically the essence and scope of the Hutton scheme. On November 2, 1981, the Hutton branch office in Williamsport, Pennsylvania deposited $92,475.12 in customer funds in its account at the Northern Central Bank in Williamsport. That day, the amount drawn down from the account into the firm's prime concentration account was $925,000. The difference, $832,524.88, was made up by a check drawn in that amount by Hutton's Williamsport branch office on the firm's zero balance account at Chemical Bank in New York City. This pattern was repeated at the Northern Central Bank throughout November 1981.

On the same day, November 2, 1981, the Hutton branch office in Alexandria, Virginia received customer funds in the amount of $70,629.46 which it deposited in its account at United Virginia

Bank. The amount drawn down from the account that day was $9,953,400. The overdraft was covered with a zero balance account check. Between January and December 1981, the Hutton branch in Alexandria received a total of $33,537,397.20 in customer funds and withdrew from its depository account at United Virginia Bank some $640,796,712.08, well over one-half billion dollars in overdrafts. The average daily overdraft at this bank was approximately $9,000,000 in November 1981.

A complimentary, and more pernicious, scheme was the practice of "chaining" whereby Hutton caused funds to be transferred between various branch and regional depository bank accounts prior to deposit in a prime depository account for the purpose of providing additional points for the arbitrary increase of withdrawals and to increase the opportunity for and likelihood of delays in the clearing times of the covering "zero balance" checks.

In the course of the investigation, approximately fifty such "chains" were uncovered which operated in all parts of the country during 1981 and part of 1982. The practices of "chaining" and arbitrary overdrafting occurred principally in 1981. Within several months of the collapse of the Genessee/United Penn kite, those activities were halted.

By overdrafting as much as $250 million per day from its depository accounts, and perpetuating its overdrafts on successive days, Hutton both avoided the necessity to borrow extensive amounts of working capital and earned interest income on surplus funds.

Under one part of the plea agreement, Hutton was enjoined in the §1345 civil injunctive proceeding from engaging in two additional practices not charged in the criminal information. The first was the use of a "draw down sheet" or formula by which Hutton sought to overdraft its depository bank accounts in an amount which it claimed compensated the firm for the weekend and holiday periods during which funds were unavailable to Hutton. The essence of the draw down sheets was a "multiplier" which increased the amount withdrawn on certain days by a factor of two, three or four.

Hutton's objective in using the draw down sheet and its multiplier was to achieve a "target" or average balance of zero in each of its branch depository bank accounts. To the extent that banks held Hutton funds on weekends or holidays, Hutton recaptured use of that money by precisely calculated overdrafts. While this conduct was not as egregious as the massive, arbitrary overdrafting exemplified by the Williamsport and Alexandria cases, the activity was far more pervasive. Unfortunately, from a criminal prosecutive standpoint, the target balancing technique may be relatively common and was certainly one not considered illegal by Hutton's employees. Without the §1345 civil injunction, the target balance activity would have continued at Hutton.

Another practice was the daily "criss-cross" of checks between two Hutton bank accounts for the purpose of inducing these banks to certify a daily opening balance in each account. Both banks were thereby induced to certify that Hutton had opening balances aggregating substantial sums when the actual aggregate balance was almost zero.

All of these activities--both the practices charged in the information and the activities prohibited in the final judgment of permanent injunction in the civil proceeding--were designed, instituted and promoted by Hutton's money management personnel. The investigation developed insufficient evidence to merit the prosecution of any individuals superior to these persons in the Hutton organization.

There are two primary reasons why the money management personnel, rather than senior management, were responsible for these abuses. First, the operations of a brokerage firm such as Hutton are organized into two functional areas; the "front office," which performs all the sales related activities and the "back office," which handles the paperwork generated by the front office and all of the other day-to-day operations of the firm. The registered representatives are the best compensated and are rewarded by promotion to management positions. The back office personnel, who perform the mundane, albeit, in some cases, extremely responsible, tasks are not well compensated and have virtually no opportunity to advance into the senior management levels of a brokerage firm. Senior managers, selected without exception from the ranks of the front office, have neither the experience nor inclination to become involved with back office management. Second, unlike some other major brokerage firms, Hutton's regional and branch operations were effectively "decentralized." Indeed, the regional and branch managers were encouraged to be independent; Hutton closely monitored profit and loss figures for each branch.

It was in this context that Hutton's money managers operated. It was clear from the investigation that they lacked the authority to impose uniform money management procedures throughout the Hutton branch office organization. Although various "draw down" sheets were devised and tinkered with and small meetings and seminars held at irregular intervals to encourage their use, not all branch offices followed the money management office's suggestions. One major reason was that the formula computations required to complete the draw down sheet were complicated and not every branch manager or cashier could do them. Few of the branch cashiers grasped the illegal nature of the activity which the sheets fostered. Furthermore, the evidentiary link between Hutton's money management office and the type of activity found at the Williamsport or Alexandria branch offices was tenuous. Hutton's policy of considering each branch office as an independent profit center led, inexorably, to a sharing with the branch offices of a portion of the interest income being generated by the money management techniques. Some branch office managers, whose compensation was, in part, based upon their office's profitability, were undoubtedly tempted by the opportunities for indirect personal benefit provided by the ability to engage in overdrafting of branch depository accounts.

Legal Theory and Problems

Check kiting became extremely difficult to prosecute under federal law as a result of the Supreme Court's decision in United States v. Williams, 458 U.S. 279 (1982). The typical check kite case had been prosecuted in the federal system as a violation of 18 U.S.C. §1014. The relevant language is:

> "Whoever knowingly makes any false statement or report, or willfully overvalues any land, property or security, . . . for the purpose of influencing in any way the action of . . . any bank the deposits of which are insured by the Federal deposit Insurance Corporation . . . upon any application, advance, discount, purchase, purchase agreement, repurchase agreement, commitment, or loan, or any change or extension of any of the same, by renewal, deferment of action or otherwise, or the acceptance, release, or substitution or security therefor, shall be fined not more than $5,000 or imprisoned not more than two years, or both."

The theory employed by federal prosecutors was that a kited check was an "overvalued security" or a "false statement." The Supreme Court held, however, that a check does not "make any representations as to the state of petitioner's bank balance," 458 U.S. at 285, nor is it an overvalued security."

The consequence of Williams was to limit drastically federal law enforcement's ability to prosecute check kites. As a result, the Department of Justice recommended remedial legislation in the form of a comprehensive bank fraud statute. That statute, now codified at 18 U.S.C. §1344, was adopted as part of the Comprehensive Crime Control Act of 1984. The legislative history makes it clear that §1344 reverses Williams.

Before passage of §1344, the principal alternative to §1014 as a check kite prosecutive vehicle was mail or wire fraud in the limited cases where those statutes applied. In the Third Circuit, however, Williams, took its toll on the "mail fraud/wire fraud" approach to the prosecuting check kites. In United States v. Frankel, 721 F.2d 917 (3rd Cir. 1983) the Court relied on Williams to conclude that a check kite could not be charged under the "false pretenses, representations and promises" clause of 18 U.S.C. §1341 because a check was not a representation. Frankel left open the possibility of a prosecution under the "scheme to defraud" clause, but failed to explain how that could be done. 2/

The net effect of the Williams and Frankel decisions was to eliminate almost completely our ability to prosecute check kites in the Third Circuit. Finding a theory that would not lead to a dismissal under either Williams or Frankel was not simple. The theory that was adopted focused on Hutton misrepresenting its relationship to the banks: Hutton held itself out as creating depository accounts to handle only customer money where in fact the accounts were used to process huge overdraft checks. This is a rather unconventional prosecutive approach to check kiting and turned completely on our ability to establish persuasively that

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2/ The possibility of ITSP (18 U.S.C. §2314) remained, but only as an illusion since that statute requires proof of a fraud. The Williams and Frankel problems led again to the issue of how to define the fraud without relying on the overdraft check as a misrepresentation.

the depository accounts were intended for a highly specific limited use. Obviously, this creative circumvention of Williams and Frankel would have been tested vigorously by a motion to dismiss.

The second legal defense we expected to face was a claim of good faith. Hutton asserted that it had done nothing wrong and was guilty merely of aggressive money management. Hutton also alleged it had merely attempted to "recapture float" that did not belong to the banks. Hutton insisted that its practices were no different than those of other companies.

The third legal attack on our case, available to the individuals who might have been charged, was the simple claim that each was acting pursuant to corporate policy and because Hutton had the means to pay the banks, the requisite mens rea was absent. It is clear that each of the few employees that might have been prosecuted firmly believed his conduct was legal.

The final legal defense was essentially the caveat emptor view that since the banks in fact could observe the transactions, they acquiesced in them.

Process of Evaluation

The Criminal Division was first apprised of the Hutton investigation on March 5, 1984. In April 1984, Fraud Section Chief Robert W. Ogren met in Harrisburg, Pennsylvania with Assistant United States Attorney Murray, Inspector Holland and a number of postal inspectors. The purpose of the meeting was to explore possible theories of prosecution, assess the progress of the investigation, and assess whether staffing of the investigation was adequate.

By mid-summer, it was clear that an additional prosecutor was needed to co-counsel the case, to share the work load with Assistant United States Attorney Murray, to complete the grand jury investigation and to assist in sharpening the focus of the remainder of the investigation. Peter B. Clark of the Fraud Section of the Criminal Division was selected.

Assistant United States Attorney Murray had begun working on a draft indictment in the summer of 1984. The timetable to which the prosecutive team sought to adhere contemplated returning of an indictment in November 1984, shortly before the grand jury's term expired. Thereafter, the grand jury's term was extended for six months to May 1985 finish the investigation and to permit thorough review of the evidence and theory of prosecution.

Simultaneously with our efforts to complete the investigation late in 1984, the various defense counsel representing Hutton and several targeted individuals sought to make presentations to United States Attorney David Dart Queen in Scranton, Pennsylvania and to the Criminal Division. Mr. Ogren responded to all requests from counsel to meet with Department officials by requiring counsel to present their positions in the first instance to the United States Attorney in Scranton. Several meetings were held in Scranton at which the prospective defendants' positions were set forth. These meetings were held in October and early November.

Counsel for Hutton then requested the opportunity to make written presentations to the Criminal Division and to make an oral presentation to Assistant Attorney General Stephen S. Trott. We agreed to review Hutton's written position and prescribed a timetable for written submissions. The written submissions, which were voluminous, were reviewed in detail. We subsequently agreed to meet with counsel and the oral presentation was scheduled and held on January 7, 1985. [3]

In mid-January 1985, in Harrisburg, Fraud Section Chief Ogren reviewed the evidence against Hutton with Messrs. Murray, Clark and Holland. [4] The purpose of this review was to provide a recommendation to Assistant Attorney General Trott for or against indictment of Hutton. This review led to the conclusion that criminal charges for mail and wire fraud could be brought against Hutton if the theory of prosecution was narrowly focused on the grossly excessive overdrafts and the phenomena of overdraft "chains." It was also clear that the evidence might support charging some individuals but review of that issue was temporarily deferred. Meanwhile, Mr. Ogren requested Messrs. Murray and Clark and the Postal team to develop evidence of additional chains as a priority matter. Fraud Section Chief

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[3] Attending were Trott, Deputy Assistant Attorney General Victoria Toensing, Ogren, Clark, Murray, Holland and Supervising Postal Inspector Thomas Dagley, plus counsel for Hutton.

[4] In January 1985, United States Attorney Queen resigned his office and the Fraud Section of the Criminal Division, which had been assisting in the investigation, assumed direct supervision of the matter.

Ogren reported his conclusions and recommendations to Mr. Trott, who in turn asked Mr. Ogren to advise Hutton's counsel that he had made a decision to proceed to indict. Mr. Ogren advised Hutton's counsel of Mr. Trott's decision.

Two weeks later, in Harrisburg, Messrs. Ogren, Murray, Clark and Holland conducted an intensive review of the evidence against target individuals. The preliminary assessment was that we had sufficient evidence to proceed against two Hutton employees. The tentative conclusion was also reached that additional evidence would be required before any other individuals could be added to the list of probable defendants. Counsel for the employees were advised of our decision and in turn they sought to make presentations on their clients' behalf. Meetings with these counsel took place in February 1985. 5/

Assessment of Risks of Trial

A major component of the judgmental equation was the risk faced in litigating the criminal case with two or more individuals joined as defendants.

An indictment would have resembled the information, but would have been limited to counts involving jurisdictional uses only in the Middle District of Pennsylvania. The focus of an indicted case would have been on two types of check abuses: the arbitrary overdrafts exemplified by the Williamsport and

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5/ Attending for the government were Messrs. Ogren, Clark, Murray and Holland.

Alexandria situations and branch-to-branch chains exemplified by the Genessee/United Penn kite. In order to demonstrate the breadth and significance of the scheme we expected to prove six or more arbitrary overdraft situations and at least twenty chains.

The scope and complexity a potential trial was unprecedented. Of the 7,000,000 documents subpoenaed by the grand jury, our estimate is that several hundred thousand would have been needed at trial. The number of authenticating witnesses alone would have exceeded 200.

Several hundred descriptive charts would have been required. Approximately 20 charts were prepared for use in the Rule 11 proceeding simply to explain the theory of the government's case to Chief Judge Nealon.

In addition to hundreds of authenticating witnesses, we would have presented over one hundred fact witnesses and a number of experts.

Pretrial discovery in this case would have taken months.

Although the case management problems of the prosecution were enormous, and the expense of the litigation would have been considerable, other factors were of greater importance.

Put bluntly, this case was not a sure winner against individuals. The probable legal defenses mentioned above were not weak. In addition, there were a number of serious practical problems. The most significant:

° The prospective individual defendants did not gain personally from their offenses. This defense has historically been an effective one with juries. Our most recent example is the acquittal on May 10, 1985, of George McLean, a former International Harvester employee, in the Pemex FCPA prosecution.

- The banks in many instances should have uncovered the fraud. It could appear they had turned their heads to avoid discovering it (in which case it would have been argued that it was not a fraud).
- We recognized that two attitude factors might contribute to jury nullification: one might best be described as a "to hell with the banks" attitude; the second, the "there but for the grace of God go I" attitude reflecting the reality that, at one time or another, most jurors have overdrawn their accounts. These two attitudes, coupled with a defendant's demonstrable ability to pay, have historically made check kite and bad check cases extremely difficult to prosecute successfully.
- Severance problems. In all likelihood, one individual defendant would have been entitled to a severance. Thus the case would have been tried twice.
- Confusion. Although, we believe the clarification of the theory of prosecution and limitation of the proof to arbitrary overdrafts and chains was constructive, the government's evidence was complex and difficult to understand. It is noteworthy that after several weeks of our providing detailed briefings and answering questions for Congress and the Press, only a handful of the

reporters and political figures who have written or commented on the case appear to have any idea what the case is about. Many simply still do not understand the facts.

Our final assessment was that at trial we would probably prevail against the Company. Our prospect to prevail in a trial against specific individuals was considerably less certain.

Evaluation of Negotiations

A major objective of the prosecution was not only to bring an immediate halt to Hutton's money management abuses, but also to make the case a landmark that would establish specific standards of practice for money management. This second objective was linked to our assessment that Hutton's practices, if replicated by financially precarious companies, had tremendous potential for harming banks, particularly the smaller, more vulnerable banks.

At the time we commenced plea negotiations with Hutton, we had assessed our prospects of success in an indictment and trial along the lines discussed above. Essentially, the maximum we could realistically obtain through litigation was the following:

- Indictment and conviction of the Hutton brokerage subsidiary and possibly its parent, Hutton Group, on approximately 500 mail and wire fraud counts each (the maximum as to which we had venue in the Middle District of Pennsylvania) with a maximum aggregate fine of

$1,000,000.

- No recovery of the costs of investigation, but recovery of some costs of prosecution.
- Restitution, but possibly limited only to bank victims in the Middle District of Pennsylvania. Restitution would have to await exhaustion of all appeals.
- Injunctive relief against Hutton for ongoing practices could not be obtained during the pendency of the criminal case because a contemporaneous civil proceeding would have created difficult parallel proceeding problems.
- Prosecution and conviction of the only individuals against whom there was sufficient evidence to indict and possible imprisonment. However, because they had not personally profited from the offenses, the likelihood that either would be imprisoned was low, assuming that convictions were obtained.

These objectives could only have been obtained via an extraordinarily lengthy, complex and chancy trial.

The results achievable by plea disposition, on the other hand, were clearly far superior. The issue was simply whether the prosecution of two mid-level individuals, who had not personally gained from the fraud, was of sufficient importance that it warranted accepting the enormous litigation cost and risks that a trial would require rather than the immediate and dramatic benefits provided by the terms of the disposition. Our assessment was that the terms of the plea bargain accomplished such a high percentage of our enforcement goals that it should be accepted.

The Criminal Division policy regarding the prosecution of corporate officials and employees for acts of wrongdoing is that corporations act through individuals and, therefore, individuals must be held accountable for corporate actions. That policy, when placed beside the facts, uncertainties and legal ambiguities of this case, would, if inflexibly applied, have forced us to reject a plea agreement that in many significant ways accomplished more than we could have achieved by a trial. In addition, it would have saddled us with a trial of unprecedented difficulty and high risk. That policy, however, is an important one and is sacrificed only when there is an overriding interest in doing so. The benefits derived from the Hutton plea were so substantial that they clearly warranted an exception to our policy.

The judgment in this case was most heavily influenced by two factors: first, Messrs. Murray, Clark, and Ogren viewed it as absolutely essential to obtain an injunction that barred the full range of Hutton's overdraft practices including the use of the draw down sheet and its multiplier. Hutton had made clear to us its intent to continue its draw down practices involving the use of the multiplier without disclosure to its banks. Hutton further indicated that it was computerizing the process to make it more efficient and uniform throughout the firm's operations. Second, the practices Hutton employed are believed to be wide spread and to cause large interest losses to banks, which posed the threat to inflict huge losses on banks if the overdrawing broker or business failed. Because of Williams, and under the facts of this case, these practices could not be reached by an indictment. However, an injunction, based on the bank fraud statute that overruled Williams, would provide a visible enforcement vehicle.

We ultimately viewed our choice as one between an uncertain prospect of convicting two mid-level individuals who did not gain from the fraud against the certainty of a broad based enforcement stroke that could immediately wipe out cash management abuses throughout the business community.

Conclusion

Based on the foregoing assessment, Messrs. Ogren, Clark and Murray recommended that the plea bargain reflected in Plea Agreement filed with the Court be approved. The key elements of the disposition are:

1. Hutton guilty plea to 2,000 Counts of mail and wire fraud. Fine of $2,000,000 (the legal maximum).
2. Hutton payment of $750,000 in investigative costs (not otherwise recoverable).
3. Hutton make full restitution, plus interest.
4. Hutton take a series of actions to inform and educate its employees in order to prevent a recurrence of abuses.
5. Hutton consent to an injunction that prohibits arbitrary overdrafting, chaining, use of multiplier or

formula, criss-crossing and requires full disclosure of its cash concentration practices to its banks.

The disposition was approved by Assistant Attorney General Trott. Following action by Hutton's Board of Directors, Hutton entered its guilty plea and consent to the injunction before Chief Judge Nealon on May 2, 1985.

E.F. HUTTON MAIL AND WIRE FRAUD CASE

THURSDAY AUGUST 1, 1985

House of Representatives,
Subcommittee on Crime,
Committee on the Judiciary,
Washington, DC.

The subcommittee met, pursuant to call, at 9:30 a.m., in room 2141, Rayburn House Office Building, Hon. William J. Hughes (chairman of the subcommittee) presiding.

Present: Representatives Hughes, Mazzoli, Morrison, Feighan, Smith, Staggers, McCollum, Lungren, Shaw, and Gekas.

Staff present: Hayden W. Gregory, counsel; Virginia E. Sloan, assistant counsel; Theresa Bourgeois, staff assistant; Eric E. Sterling, assistant counsel; Edward H. O'Connell, assistant counsel; Fred W. Stuckwisch, GAO consultant; Charlene Vanlier Heydinger, associate counsel; Phyllis N. Henderson, clerk.

Mr. Hughes. The Subcommittee on Crime will come to order.

The Chair has received a request to cover this hearing in whole or in part by television broadcast, radio broadcast, still photography or other similar means. In accordance with rule 5(a), permission will be granted unless there is objection.

Is there objection? Hearing none, such coverage is permitted.

Today is the third in the Subcommittee on Crime's series of oversight hearings on white-collar crime and, in particular, on the investigation by the Department of Justice into the E.F. Hutton mail and wire fraud case.

In our first hearing, on June 19, we took testimony from high-level executives of Hutton. We learned about senior management's perspective of the case, and about the actions they took after Federal authorities began investigating Hutton's cash management system.

In our second hearing, July 19, we heard from representatives of the Department of Justice about the Department's difficulties in cooperating with this subcommittee's oversight investigation. We have on countless occasions requested that the Department make available to the subcommittee documents and other materials relevant to the *Hutton* case, and have on each occasion been told that those materials are shielded by Federal grand jury secrecy rules.

While we strongly disagree with this contention, we are continuing to discuss the matter with the Justice Department.

I note that after the July 19 hearing, in response to Congressman Mazzoli's suggestion, the Department has finally agreed to return to Hutton the documents Hutton provided to the grand jury, with the expectation that Hutton will then turn those materials over to the subcommittee in response to our subpoena.

I am glad that the Department seems to have found a partial way out of the difficult spot in which it placed itself. However, I must reiterate my past statements that producing the Hutton materials is not sufficient to constitute cooperation with this subcommittee.

Our request for the Department's own materials—analysis of the investigation, investigative and decisional memoranda, and the like—is still pending. We continue to expect full cooperation from the Department of Justice in this matter, and we think that progress is finally beginning to be made in this respect.

In our third hearing today, we will hear from lower level Hutton officials—the branch and regional employees who helped to carry out the scheme to overdraft Hutton's bank accounts and to create float by setting up "chains" of Hutton accounts in the hope that clearing times would be delayed.

We will also hear from a past "money mobilizer" at Hutton who created the cash management system that we are scrutinizing. We will be interested in hearing William Sullivan's description of the system he created, how it functioned and was implemented as company policy, and any changes that were effected after he left the company's employ.

The subcommittee at this time would recognize Mr. McCollum, the ranking Republican.

Mr. McCollum. Mr. Chairman, I don't have an opening statement.

I look forward to learning more about this E.F. Hutton matter. I know the public concern with it and I appreciate very much the fact that the committee is taking the time to fully explore it in depth. These look like very interesting witnesses this morning. And I yield back.

Mr. Hughes. Any other members have a statement?

If not, our first witness this morning is Mr. William Sullivan. Mr. Sullivan was hired by the E.F. Hutton Co. in 1974, and became the company's first money mobilizer. He was also the bank relations officer. He left Hutton in April or May 1980, and was succeeded in June 1980 by Mr. Thomas Morely.

Mr. Sullivan, on behalf of the Subcommittee on Crime, we welcome you.

Pursuant to clause 1 of rule XI and clause 1 of rule X of the House of Representatives, this hearing of the Subcommittee on Crime of the Committee on the Judiciary is an oversight investigation of the E.F. Hutton mail and wire fraud case.

Let the record indicate that pursuant to clause 2 of rule XI of the Rules of the House of Representatives, copies of the rules of the Committee on the Judiciary of clause 2 of rule XI of the House have been made available to the witnesses and are available at the witness table.

Mr. Sullivan, you have a right to counsel to assist you in the course of this morning's proceeding. Are you accompanied by counsel?

Mr. Sullivan. Yes, I am.

Mr. Hughes. Can you identify counsel for the record?

Mr. Sullivan. Mr. Charles Stillman and Mr. Peter Chavkin.

Mr. Hughes. I am going to now place you under oath, Mr. Sullivan. Will you please raise your right hand?

Do you solemnly swear or affirm that the testimony you are about to give to this committee is the truth, the whole truth and nothing but the truth, so help you God?

Mr. Sullivan. I do.

[Witness sworn.]

Mr. Hughes. You may be seated.

Mr. Sullivan. Thank you.

Mr. Hughes. Mr. Sullivan, you may proceed as you see fit. You have a statement which, without objection, will be made a part of the record in full, and you may proceed.

TESTIMONY OF WILLIAM SULLIVAN, FORMER MONEY MOBILIZER, E.F. HUTTON

Mr. Sullivan. I would like, Mr. Chairman, just to read a summary of that statement, if I may.

Good morning, Mr. Chairman and members of the committee and staff. My name is Bill Sullivan, and I am pleased to appear before you today.

I was the E.F. Hutton money manager from April 1974 to May 1980. I left E.F. Hutton before the start of the activity which underlies the charges filed by the Government against Hutton.

As one of my money management programs, I refined Hutton's original drawdown system. My mechanism was designed to move into Hutton's few main concentration bank accounts the moneys received each day by the firm's many branches and regions, and also to extract the cash value of any moneys left with the branch banks.

This system was distinguished by three attributes. First, the drawdown of moneys was not predicted or guessed at; it was precisely quantified by recognizing the impact of past and present events.

Second, my mechanism's premises had to be endorsed by the banks before it could be utilized.

Third, I required branches to leave their banks with a cash amount each day to compensate for services provided by those banks.

At no time did I receive any complaints from any bank about the operation of my drawdown system, nor, to the best of my knowledge, did Hutton, and I was never requested by any bank to make any extra payment to compensate it.

I might add that no bank requested me to close an account while I was at Hutton.

I regarded the banks as indispensable partners in my money management efforts and I enjoyed an open and friendly working relationship with them across the country.

I am now prepared to answer any questions you may have.

Mr. Hughes. Thank you, Mr. Sullivan.

[The statement of Mr. Sullivan follows:]

SUBMISSION OF WILLIAM T. SULLIVAN, JR.

TO THE SUBCOMMITTEE ON CRIME

OF THE JUDICIARY COMMITTEE

OF THE HOUSE OF REPRESENTATIVES

August 1, 1985

William T. Sullivan, Jr.

William Sullivan, 40, held the position of money manager at E. F. Hutton & Company Inc. from April, 1974 until early May, 1980. The criminal activity at Hutton began, according to the charges filed by the United States Department of Justice, after he left Hutton's employ.

While at Hutton, Mr. Sullivan developed a responsible cash management program, which included a refinement of the drawdown system in use at Hutton before he arrived in 1974. No aspect of his cash management program generated complaints from any bank. In addition, among his other cash management activities while at Hutton, he developed a cash management program for the State of West Virginia with that state's treasurer and a cash management program for the Arizona State Retirement System. Both drew sustained written praise from officials in these states.

Presently, Mr. Sullivan is chairman of Cadre Consulting Services, a firm which consults both governmental and private entities across the nation on the effective use of their investable cash. His work includes the administration of school district liquid asset funds in several states and the instruction of business and school officials in the area of cash management. In performing these functions, Mr. Sullivan and his company are constantly involved in a cooperative effort with large and small banks across the United States.

SUMMARY OF STATEMENT OF WILLIAM T. SULLIVAN, JR.

I was E. F. Hutton's money manager from April, 1974 to May, 1980. I left Hutton before the start of the activity which underlies the charges filed by the government against them.

As one of my money management programs, I refined Hutton's original drawdown system. My mechanism was designed to move into Hutton's few main concentration bank accounts the monies received each day by the firm's many branches and regions, and also to extract the cash value of any monies left with the branch banks. This system was distinguished by three attributes. First, the drawdown of monies was not predicted or guessed at -- it was precisely quantified by recognizing the impact of past and present events. Second, my mechanism's premises had to be endorsed by the banks before it could be utilized. Third, I required branches to leave their banks with a cash amount each day to compensate for services provided by those banks.

At no time did I receive any complaints from any bank about the operation of my drawdown system, nor, to the best of my knowledge, did Hutton, and I was never requested by any bank to make any extra payment to compensate it. ① I regarded the banks as indispensable partners in my money management efforts and I enjoyed an open and friendly working relationship with them across the country. ②

Chairman Hughes, Members of the Subcommittee:

My name is William T. Sullivan, Jr. and I served as E. F. Hutton's money manager from April, 1974 to early May, 1980. I was no longer working at Hutton when the activity began which was charged as a crime by the United States Department of Justice and to which the company pled guilty. I want to thank you for the chance to appear before you to explain the origins of my cash management system and to discuss what I believe to be the principles of fair cash management. I hope that my meeting with staff counsel a few weeks ago was also helpful in that regard.

When I began as money manager at Hutton in 1974, I had never before worked as a cash manager or with cash management nor did I have any experience in the field of banking. All of my experience before joining Hutton was in supervising the daily operations of branch offices of two different securities firms. Additionally, in 1974, the use by the securities industry of formal, effective cash management procedures, as I later came to realize, was only in its most primitive stages.

I learned my money management practice from 1974 to 1980, principally through discussions with bankers here and abroad. Partly because the bankers were my teachers and partly because all money management practices involve, in my view, a partnership between a company and its banks, I have always believed and stressed to the people I have trained and worked with that it is essential that a company treat its bank fairly. In other words, banks are essential for the business that a brokerage firm conducts and it is, therefore, essential that those banks be left with the funds that are necessary to make it worthwhile for them to handle that brokerage firm's account. So, it has been a cardinal tenet of my philosophy as a money manager that you should never try to exploit your bank.

I developed several money management procedures while I was at Hutton but the one which I understand you are interested in is my drawdown system. That system was, in a word, premised on taking back for Hutton the value obtained by a bank on funds which Hutton unintentionally left with that bank. My drawdown system, as I will explain shortly, was neither the first cash management mechanism I implemented nor the most significant of the many programs I developed. In fact, my drawdown mechanism principally involved an area of the Hutton firm -- the branches -- on which I was only able to focus my attention after three years. Further, in terms of investable dollars saved for the firm, it was a far less important mechanism than several others I developed during my tenure; indeed, it was up to each of the individual branches to decide on its own whether it wished to utilize my drawdown system.

Before discussing the mechanics of my drawdown mechanism, it may be helpful if I take a moment to explain what I mean when I say that money has a value since it is that value, and only that value, which lies at the core of my drawdown mechanism. A brokerage firm, like any company, needs money to operate. So, for example, when a customer buys a stock on margin, the customer is required to provide the brokerage firm with only part of the full purchase price and the brokerage firm then needs to provide the remaining funds on the customer's behalf; when a customer does not pay for his stock purchase on the date of settlement, the brokerage firm again must advance money on behalf of the customer. The answer typically is that a firm like Hutton will take out a loan and a loan, of course, costs money -- today, 9 3/4%. My principal goals as a money manager were first, not to borrow money needlessly; second, to reduce loans wherever I could; and third, to borrow at the lowest possible cost to the firm. One way to help reduce the cost to a firm of borrowing money is to maximize the use of all investable dollars. As part of that, it is essential to use any money which the company unintentionally has left idle. As you can see, an unused dollar at Hutton -- a dollar which is not spent or committed in some way -- is worth an additional 9 3/4% because it could be used instead to pay off one dollar of an outstanding loan. My drawdown system was designed to detect such idle investable dollars at Hutton and to maximize their use.

Now, as you may be aware, Hutton had a drawdown system before I got there in 1974. It was a system designed to concentrate in Hutton's New York headquarters on a daily basis the monies taken in by the many Hutton branches.

That basic drawdown system was supposed to work essentially as follows. Every day, a Hutton branch would advise the region where it was located of the amount by which its bank account deposits exceeded its withdrawals. The region had that branch's checkbook and would write a check against that branch's account for that amount and then deposit the check into the region's bank account. The region would do this for every branch in its area and, later that same day, Hutton's New York headquarters -- which had a checkbook for each region's bank account -- would write a check corresponding to the difference between that region's daily deposits and withdrawals.

This system continued in operation until roughly 1978, several months after a banker from a West Coast bank visited me at Hutton to thank me for leaving his bank with over $400,000 in daily balances. This surprised me, since I had thought that Hutton's original drawdown system would theoretically take all of the funds out of a branch's account each day. The banker explained to me that the large balances left behind resulted from two factors. First, the banker explained that roughly 70% of the Hutton branch's deposits into his bank were checks written off of his bank by other bank customers and these checks provided immediately available funds (cash value), although the Hutton branch did not treat them as such. Second, on occasion, checks -- including the drawdown check written by the region on that branch's bank account -- would not be presented to the branch's bank the following day because of an unexpected delay in the bank clearing system. The banker confirmed these facts by showing me his bank's account analysis for my branch's account.

The information provided by this banker prompted me to examine Hutton's drawdown system more carefully. At the same time, I had reached a point in my experience as a money manager where I could devote myself to an in-depth scrutiny of the means by which the local Hutton branches handled the monies they received daily. In the course of conducting that review, I generally found two things. First, as the West Coast banker advised me, branches were depositing many cash value items without extracting the cash value in their daily drawdown. Second, some branches were including in their daily drawdown amounts of monies which they expected to receive from customers the following day. These branches thought that this practice was effective cash management but I found that on a daily basis, those branches, without realizing it, were still leaving their banks with large amounts of investable dollars. I found the practice of anticipating customer payments to be ineffective, and it confirmed my view that guessing or predicting was bad cash management.

The ultimate result was that I created an "addition" to drawdown mechanism to reduce the excess balances the branches were leaving with their banks while insuring that those banks were left with ample daily cash balances to compensate them for the services they provided. I introduced this system, which I am about to explain, to Hutton's regional offices across the nation at a national meeting in 1978. The purpose of my presentation at that meeting was to instruct the regional office representatives in the operation of my drawdown mechanism so that they would be able to instruct their branches on its use. At this session, I stressed that guesswork was improper and was, in any event ineffective, and further, that my drawdown mechanism, if followed, would eliminate all guesswork and enable each branch to accurately recognize the exact amount of investable dollars that it had left with its bank. I subsequently appeared at several training classes for branch managers and their assistants to explain Hutton's overall cash management program, including these aspects of the drawdown system.

As I instructed, the "addition" to drawdown mechanism was strictly optional. Moreover, even before a branch could use it, there were significant preconditions. The branch first had to learn from its bank whether that bank was prepared to give the branch cash value tomorrow on checks deposited today and cash value today on checks deposited from customers of the same bank. In addition, the branch had to learn what time of day it had to make its deposits in order to obtain this kind of availability on its deposits and the branch had to request its bank to provide an account analysis, to insure that Hutton and the bank could monitor how the system was operating. I further instructed that this account analysis be sent to me in New York so that I could personally review that the branch was effectively extracting investable dollars while leaving with its bank sufficient compensating cash balances. I have attached as Exhibit A a copy of a typical bank account analysis.

If and only if these preconditions were satisfied, the branch was then entitled to utilize my "addition" to drawdown sheet. The sheet, as I mentioned earlier, was designed to enable Hutton to extract the full value of the monies it had inadvertently left with a bank, less a daily compensating amount. If followed, the sheet would accurately attain that goal, as well as recognize almost to the penny, rather than predict, when in the past the bank had unexpectedly obtained the value of Hutton funds because of a delay in the bank clearing system -- that is, where "float" had occurred. Float is today still a natural part of the bank clearing system, as recognized by the Federal Reserve.

Essentially, the sheet worked as follows. Where cash or its equivalent (like a check deposited from a customer of the same bank) was deposited in the branch's bank account and no other transaction occurred at the branch that day, the value of that cash deposit was drawn down twice: once as it always had been under the traditional drawdown system and a second time as an addition to the drawdown amount. The reason for this was as follows. A cash deposit was immediately available to the branch, meaning that the branch could immediately withdraw or invest the cash amount. One way to get its immediate value out was by withdrawing it in a cash instrument -- by wire or cash withdrawal. But because this was too cumbersome and costly a way to get the value of cash into the regional offices from branches all over the United States, Hutton relied, as I mentioned, on drawdown checks. Since a check is an instrument that has cash value only tomorrow, not today, the use of a check to withdraw the value of cash required that the check be written for twice the amount of the cash because by the time that the check amount was available as cash to the branch, it was tomorrow and by that time, the bank had had the value of the cash in the branch's account for two days. In order to avoid overdrawing the bank account by the drawdown check, branch cashiers were instructed that on the day after the drawdown check had been written by the region against the branch's account -- which was the day that that check for twice the cash amount was presented to the branch bank for withdrawal against available funds -- the branch should cover the excess amount required by the "addition" to drawdown with the customer payments it received and, where necessary, a Hutton reimbursement check.

An example may help. On Monday, assume the branch bank account has received $50 cash and no other transactions occurred. On that same day, the region was advised to draw down the branch by writing a check against the branch account for $100. By Tuesday, the branch's bank would have had the value of the $50 cash for two days, which is cumulatively the same as having the value of $100 for one day, but on Tuesday, the $100 check written Monday by the region off of the branch's account would have cash value to Hutton, providing Hutton with an offsetting cash value of $100. My program would then insure that checks deposited today with the branch covered the additional $50 included in the previous day's drawdown check, so that by the close of Tuesday -- the day when the bank would be overdrawn if the $50 worth of checks were not deposited -- the bank was guaranteed not to be overdrawn.

Now, as I mentioned earlier, the extraction of cash value was but one of two ways to reduce the excess cash balances left by branches in their bank accounts. The second part of my addition to drawdown mechanism related to the recognition and recapturing of float. In this second part, my mechanism did not predict when float would occur. Instead, it simply recognized where float had occurred and then recaptured the value of the float which the bank had earned off of Hutton's funds.

The mechanism worked to recapture float as follows. Each morning, the branch called its bank to learn its opening balance. The opening balance necessarily was equivalent to cash since, as I mentioned earlier, the "addition" to drawdown mechanism was only to be used with banks which agreed to give the branch cash value for checks one day after they were written. After learning the opening balance, the branch would subtract the previous day's drawdown check to the region as well as checks written by the branch to local customers because the mechanism assumed that any check written against a branch's bank would be presented to the bank for collection the next day. If the result of the subtraction was zero, then there had been no float in the system and no addition to the day's regular drawdown was needed to recapture float. If the subtraction of the previous day's checks from the bank's opening balance left a positive figure, then that demonstrated that something was still left in the bank account which should not have been there had the bank clearing system operated properly. If the branch had no other transactions in its account that day, the branch bank had had the value for an extra day of whatever the positive amount was, and my drawdown mechanism recaptured that value by adding that amount to the day's drawdown. As with the part of my system which extracted the value of cash, here too the branch was required to deposit sufficient checks on the same day so that the bank balance was never left overdrawn.

Of course in the real world, a branch always has other transactions in its bank account. My drawdown mechanism reduced any addition to drawdown that would have resulted from cash deposits or recapturing float by subtracting from that addition (i) any cash withdrawals by the branch from its bank account, and (ii) a constant cash amount left with the bank to compensate it for the services it provided the branch.

One final word about my drawdown mechanism. The "addition to drawdown" mechanism was designed to insure that in any instance where excess cash value would remain with Hutton or with the bank over the weekend, the total drawdown amount would be adjusted upward or downward depending on whether it was Hutton or the bank that benefitted from the extra days' value.

In connection with these points, I have provided an attachment (Exhibit B) which helps illustrate the operation of the drawdown sheet that I developed and have described above.

My drawdown mechanism was not designed to overdraft bank accounts by arbitrary amounts. The point of my mechanism was to get the monies from branches to their respective regions across the United States (and subsequently to Hutton's main accounts in New York and California), and whenever it happened that a bank in this process benefitted from a delay in the collection of funds, to get *that value* and nothing more back from that bank. There was no prediction in my system because it operated on the premise of working with events that had already occurred and could be accurately quantified. Moreover, in my system, branches were not drawn down into remote branches, rather than regions, to try to delay the collection of checks. When a local bank told us that it agreed to treat the checks we deposited as cash the day after deposit, the bank did so in the expectation that the primary checks deposited by the local branch were from people and companies in that same locality. As a result, to use that local bank as the account for another branch hundreds of miles distant by drawing that distant branch down into the local branch would, in my view, have been unfair to that bank, and I would not have allowed it.

I think it is significant that at no time during my years at Hutton did I ever receive a complaint from any bank about this "addition to drawdown" system nor, to my knowledge, did Hutton, and I was never requested to pay any banks additional monies to compensate them. Indeed, during my six years, I enjoyed an open and friendly relationship with banks throughout the country. I suspect that the banks felt they were treated fairly because they were always left with significant available funds each day to compensate them for their services and because my mechanism, when followed, did not take from the bank anything in advance or leave the bank short. My mechanism was designed only to recapture the value of money -- in effect, the daily value that idle money could have earned. My drawdown mechanism did not take the money itself from the bank nor did it permanently extract the money from the account; it was designed only to take out the value that the bank had obtained and it never left the bank in an overdrawn position.

I hope this provides some insight into how I developed my system and its mechanical operation. Given its complexity, I am prepared today to answer any questions you may still have about it.

Thank you.

ANNOTATED BANK ACCOUNT ANALYSIS

Account Analysis For Period Ending June 30, 1982

AVERAGE DAILY LEDGER BALANCE [this is the bank's book balance]	$327,741.82
AVERAGE DAILY COLLECTED BALANCE [this is the bank's cash (or available) balance]	$260,402.84
less RESERVE REQUIREMENTS [this is the portion of the balance which the bank is required to leave with the Federal Reserve]	$37,758.41
AVAILABLE BALANCE FOR EARNINGS CREDIT [this is the cash balance which belongs to the customer]	$222,644.43
ANNUAL EARNINGS CREDIT ON AVAILABLE BALANCE [this is an internal rate chosen by the bank]	12.37%
DDA RELATIONSHIP EARNINGS [this is the actual amount earned by the bank off of the customer's funds]	$2295.09
COST OF SERVICES [this is the amount which the bank says it requires for providing services to a customer--note, the cost figure includes profit to the bank]	$187.56
NET PROFIT [for this particular month]	$2107.53
EXCESS EARNINGS BALANCE [this is the amount of cash left with the bank by the customer in excess of the amount which the bank required customer to leave in order for bank to profit on account]	$204,449.15
YEAR TO DATE PROFIT [January to June]	$11,214.53

EXHIBIT A

ILLUSTRATION OF MY DAILY ADDITION TO DRAWDOWN SHEET

PART ONE:

Opening bank book balance, as reported to branch by bank $__________

less local checks issued by branch to customers which they deposited in other banks -$__________

less previous day's drawdown check written off of branch bank account -$__________

SUBTOTAL OF PART ONE* $__________

PART TWO:

Wired amounts received in branch account $__________

Checks deposited by customers of same bank where branch account is located $__________

less amounts wired out of branch account -$__________

less checks paid by branch to person who deposits them in bank where branch account is located -$__________

SUBTOTAL OF PART TWO* $__________

PART THREE:

Subtotal from Part One $__________

Subtotal from Part Two $__________

less cash value, if any, owed to bank** -$__________

less cash balances left with branch's bank to compensate it for services it provides to branch -$__________

TOTAL TO BE ADDED TO DAY'S DRAWDOWN $__________

EXHIBIT B

annotations to drawdown sheet:

*If Part One of sheet is being filled out on Thursday, reduce subtotal by 2/3 (i.e., multiply subtotal by 1/3), since any addition to drawdown will remain with Hutton for two extra days, Saturday and Sunday. Conversely, if Part One of sheet is filled out on Monday, multiply subtotal by 3 since branch's bank would have had the excess cash value for two extra days, Saturday and Sunday. If Part Two of sheet is being filled out on Thursday, reduce subtotal by 2/3 (i.e., multiply subtotal by 1/3), since any addition to drawdown will remain with Hutton for two extra days, Saturday and Sunday. Conversely, if Part Two of sheet is filled out on Friday, multiply subtotal by 3 since branch's bank would have had the excess cash value for two extra days, Saturday and Sunday.

**The only time that there would be a figure entered for cash value owed to the bank would be where there were withdrawals against the branch account of more cash than was deposited and the excess cash withdrawals were not matched by the "addition" to drawdown for that day, or where the "addition" to drawdown for the day was less than the compensating balance to be left with the bank daily for services provided to the branch.

Mr. **Hughes**. I wonder if we can begin first by securing some organizational information from you.

Can you tell us, basically, what were your duties and responsibilities for the entire period and who did you report to?

Mr. **Sullivan**. As money manager of E.F. Hutton & Co. during the period I was there, I was responsible for all the firm's banking, its lending relationships with the banks, and all the bank accounts throughout the firm in the United States and overseas.

I reported to a gentleman named Robert Ross, who was, at that time, a vice president in cashiering. He answered to a gentleman named Norman Epstein, head of operations.

More accurately, on a daily basis the gentleman I would speak to, even though I did not have a direct line in authority, was Mr. Thomas Lynch, who was the chief financial officer of the firm.

Mr. **Hughes**. How many people did you actually supervise?

Mr. **Sullivan**. At different parts, Mr. Chairman, I had at one time 2 people and at another time about 18 people.

During my period of 1975 to 1979, I had what was called the cash desk operations under money management but that was changed during 1979.

Mr. **Hughes**. So to whom would you go if you wanted to do more than you had authority to do?

Mr. **Sullivan**. I would always first of all check with Mr. Ross on implementing any procedures that we had at the firm. Bob was my boss.

The gentleman I would discuss my ideas, after reviewing them with many of the banks I dealt with, on a daily basis, would have been Tom Lynch.

Mr. **Hughes**. I understand the cash desk was part of your operation until sometime in the late 1970's?

Mr. **Sullivan**. Yes, sir.

Mr. **Hughes**. Can you give us a more precise date?

Mr. **Sullivan**. I believe somewhere around October, Mr. Chairman, of 1979 that responsibility was transferred over to Mr. Vacca, who also answered to Mr. Ross.

Mr. **Hughes**. Do you know when that split was made?

Mr. **Sullivan**. Not exactly, Mr. Chairman.

Mr. **Hughes**. The approximate period of time?

Mr. **Sullivan**. Latter part of 1979.

Mr. **Hughes**. Did that assist you in doing your job a little better?

Mr. **Sullivan**. The purpose of that was to take away the day-to-day mechanics of the bank balancing and the approval process, so I could devote more time to money management, yes, sir.

Mr. **Hughes**. What did that do so far as control after that split occurred?

Mr. **Sullivan**. The cash desk took in requests to pay out moneys, took in deposits and withdrawals. By having Mr. Vacca, who was formerly the firm's controller in charge of that particular operation, the firm felt it would have a tighter day-to-day control of the accounting procedures in that area.

Mr. **Hughes**. You say in your opening statement it was up to each of the individual branches to decide on its own whether it wished to utilize your drawdown system.

Does this mean that each branch could decide for itself whether or not to participate in the firm's cash management program?

Mr. **Sullivan.** That is correct, Mr. Chairman.

Mr. **Hughes.** If so, what controls did the company have over utilization of branch cash?

Mr. **Sullivan.** The drawdown system that existed at E.F. Hutton & Co. when I joined them was that the branches would collect the customer deposits for the purchase of securities and deposit in their local bank.

Those deposits were drawn down by the region and then the region was drawn down into New York. That was the basic drawdown that was in existence.

Mr. **Hughes.** OK.

Mr. **Sullivan.** During that period of time, the branches would, on their books, E.F. Hutton's books, have an overdrafted bank balance. They overdrafted their bank balances on the anticipation of deposits coming in the following day.

About 3 years after I started at E.F. Hutton, approximately the middle of 1977, I had received a visit from a banker on the west coast who had come by to thank us for the large balances that his bank was enjoying with the firm.

I was surprised that we had large balances, because basically the region drew down the check and that should be clearing the following day. And what the banker had explained to me in 1977 was that a majority of the checks were deposited, about 70 percent were drawn on his own bank, and that was a cash deposit. Since we have checks as our vehicle, we were always leaving about 70 percent of each day's deposit behind.

In addition, he showed me that not every day did the drawdown check from the region hit his bank and that added an additional value to the bank.

I studied that problem for about 4 or 5 months, and developed what I presented to you as an addition to drawdown sheet. That addition to drawdown sheet was to recapture the value of the moneys that E.F. Hutton had unintentionally left behind with the bank.

It was a voluntary program. The branches did not have to do that, because it required the branches to follow a very strict outline.

They had to call their bank. They had to find out the availability schedule. They had to ask them the same-day value for today's deposits drawn on their bank and next-day funds and all other deposits. They had to know the time of day, and most importantly, Mr. Chairman, they had to have an account analysis.

That account analysis was sent to me in New York. That is a profit and loss statement on the account with the bank.

It was an optional system because the branches had to follow a strict outline. If they did not follow this procedure, it was strictly voluntary.

Mr. **Hughes.** How would you control the use of the addition in the branches?

Mr. **Sullivan.** The drawdown sheet would result at the end of the month for an account analysis from the bank so I could review every month the account analysis sent to New York to make sure that branch was properly drawing down its bank.

Mr. HUGHES. You do understand it has the propensity for excess without proper controls.

Mr. SULLIVAN. The program, as it was implemented and explained to the regions, would not have had the ability to incorrectly draw down the right amount of money because the procedure was to follow this outline. The reason for the account analysis being sent to New York was that I could monitor that; that could not happen, Mr. Chairman.

Mr. HUGHES. You indicated in your statement, and you just alluded to it once again, that the drawdown mechanism was not designed to overdraft bank accounts by arbitrary amounts. That is your testimony.

Mr. SULLIVAN. That is correct.

Mr. HUGHES. It was designed to overdraft by calculated amounts.

Mr. SULLIVAN. It was designed to recapture the value of the moneys and the moneys that were on deposit with the bank earned money. It earns it for the bank or for the customer.

Mr. HUGHES. How does one tell when one goes from arbitrary to—or calculated to arbitrary drawdowns under that system?

Mr. SULLIVAN. I would notice it in the account analysis that was sent to New York.

Mr. HUGHES. In your statement, you indicated it has been a cardinal tenet of your philosophy that you should never try to exploit the bank.

You also suggest you think it is significant, at no time during your years at Hutton did you ever receive a complaint from any branch about this addition to drawdown system nor, to your knowledge, did Hutton and—nor were you or Hutton requested to pay additional moneys to banks to compensate for overdrafts.

Mr. Sullivan, I have some correspondence I would like to ask you about. In particular, the items are dated from January 17, 1979, to April 24, 1980, or about the time that your system was introduced until shortly before you left Hutton.

The first item is a note from W. Robert Hein, regional cashier, Los Angeles, January 17, 1979, attached to a letter from City National Bank, Beverly Hills, dated January 11, 1979.

Mr. Hein states, and I quote a portion of the letter: "We started the overdrafting early last month so the bank as yet has not seen the improvement."

What can you tell us about that situation?

Here we have a bank that was patiently complaining about aggressive overdrafting, and the suggestion is they have not seen any improvement in the account.

Are you familiar with that particular——

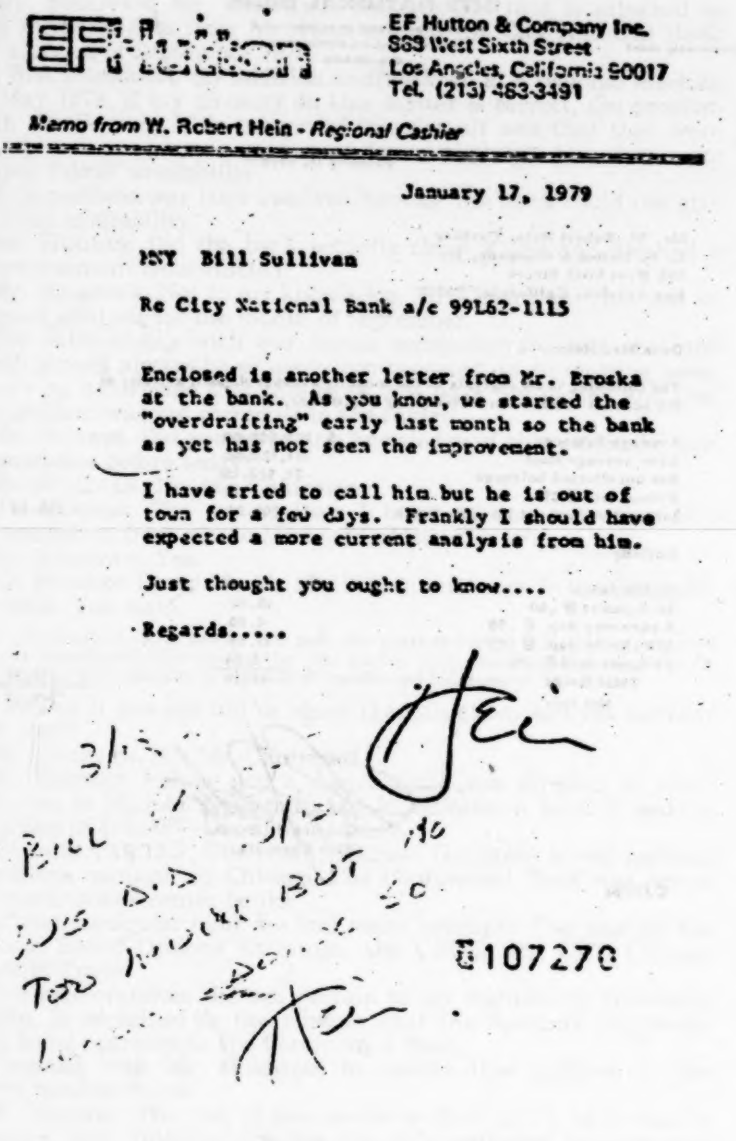
Mr. SULLIVAN. May I take a moment and see the document?

Mr. HUGHES. Yes. You have the correspondence there.

Without objection, I offer this correspondence for the record. Is there objection?

Hearing none, so ordered.

[The letter of Mr. Hein follows:]



EF Hutton & Company Inc.
888 West Sixth Street
Los Angeles, California 90017
Tel. (213) 483-3491

Memo from W. Robert Hein - Regional Cashier

January 17, 1979

NY Bill Sullivan

Re City National Bank a/c 99162-1115

Enclosed is another letter from Mr. Broska at the bank. As you know, we started the "overdrafting" early last month so the bank as yet has not seen the improvement.

I have tried to call him but he is out of town for a few days. Frankly I should have expected a more current analysis from him.

Just thought you ought to know....

Regards.....

Hein

3/1 [illegible]

BILL [illegible] ,10

D.D. BUT SO

WAS [illegible]

TOO [illegible]

[illegible]

E107270

CITY NATIONAL BANK
WILSHIRE BOULEVARD AT ROXBURY DRIVE
BEVERLY HILLS, CALIFORNIA 90210
(213) 550-5400

COMMERCIAL LOANS

January 11, 1979

Mr. W. Robert Hein, Cashier
E. F. Hutton & Company, Inc
888 West Sixth Street
Los Angeles, California 90017

Dear Mr. Hein:

The following is an analysis of the monthly average deposit activity of the account number 001-399-663 for September, 1978.

Average balance	$ 103,600.00	
Less average float	174,122.00	
Net uncollected balances	70,522.00	
Prime rate @12%	.01	
Interest earned net loanable funds	-705.22	- 705.22
Activity		
Maintenance	3.00	
36 deposits @ .50	18.00	
8 currency dep. @ .50	4.00	
568 checks dep. @ .03	17.04	
39 items paid @ .06	2.34	
Total Costs	44.38	44.38
Net loss		749.60

Sincerely,

Charles J. Broska
Vice President

CJB/ps

Mr. **Sullivan**. Mr. Chairman, the analysis that is attached to this memorandum from Mr. Hein is from the City National Bank for a period of September 1978.

I first introduced my addition to drawdown at a regional meeting in May 1978. If my memory on this matter is correct, the problem with the Beverly Hills branch of this deposit was that they were taking not one day to give next-day availability but they were taking 2 days' availability.

This problem was later resolved because the bank could not give us 1-day availability.

Mr. **Hughes**. Did the bank actually claim a loss and demand a reimbursement from Hutton?

Mr. **Sullivan**. Not to my knowledge, Mr. Chairman. This was an account analysis for the month of September.

The relationship with our banks going forward was that the banks should always be properly compensated on an ongoing basis. I have no knowledge that this bank was paid any money and that the problem was not corrected in the future.

Mr. **Hughes**. Did you have any knowledge of this particular correspondence before today?

Mr. **Sullivan**. No, Mr. Chairman.

Mr. **Hughes**. The second item I bring to your attention is a memorandum from you to Michael Goldstein, is it?

Mr. **Sullivan**. Yes.

Mr. **Hughes**. Dated March 16, 1979, in reference to the Continental Bank. You state:

> The Continental Bank has for the past few years indicated E.F. Hutton has been running uncollected balances for the year ending 1978. Continental Bank indicates they are due some $52,000 as a result of uncollected balances for the year.

I wonder if you can tell us about that situation. Are you familiar with that?

Mr. **Sullivan**. No, Mr. Chairman.

Mr. **Hughes**. I show you a memo which was directed to you—from you to Michael Goldstein, and it indicates a bank is making the claim of $52,000—Continental Bank.

Mr. **Sullivan**. Mr. Chairman, Michael Goldstein is our regional operations manager in Chicago. The Continental Bank was one of our main money center banks.

In that particular bank we had many accounts. One was for the Chicago Board Options Exchange, the CBOE, and CBT, Chicago Board of Trade.

This memorandum did not pertain to my addition to drawdown system. It pertained to the manner that the accounts in general were being operated at the Continental Bank.

I worked with Mr. Goldstein to resolve that problem in the future months ahead.

Mr. **Hughes**. The fact of the matter is that it is a bank that is unhappy over collecting—paying out on uncollected balances and the claim for $52,000 is made.

Mr. **Sullivan**. I wrote that memorandum to Mr. Goldstein after meeting with the Continental Bank.

I had very open and available lines with our banks. In fact, I had most of my lunches with my banks.

And in reviewing the account with the representative from Continental Bank—it was my memorandum, not the Continental Bank asking for payment. I believe that our banks should be fairly compensated and while I was at Hutton, that was my main goal, that the banks get fairly compensated.

This memo to Mr. Goldstein was to look at that problem and resolve that problem. It was a major money center bank that we had many operations in. But it certainly was not a request by Continental Bank for us to pay them any money.

Mr. HUGHES. There are a number of other pieces of correspondence that I will question you about, but my time is up and we are going to operate as much as we can under the 5-minute rule.

The gentleman from Florida is recognized.

Mr. MCCOLLUM. I would appreciate very much, Mr. Sullivan, if you could explain for us the essential differences between the procedure that you established for the drawdowns and the errors or excess that apparently existed in some parts or in some regions with Hutton when we have gotten into the problems of the later years after you left.

Could you explain that to us?

Mr. SULLIVAN. Mr. Congressman, I would like to explain my system first, and because I wasn't with Hutton since that period of time, I would like to address the specific item that you ask me as it was in my system.

Would that be best?

Mr. MCCOLLUM. If you would very briefly outline that for us, please.

Mr. SULLIVAN. In my system, which was operational as an addition to drawdown, the basic system was that the branch was drawn down by the region and the region on into New York. That was done because that was the fastest means to collect the check.

It was important that in each position that he put that vehicle, check, that we got next-day availability, so the fastest means was branch-region-New York. My addition to drawdown took into account that they had first confirmed with the bank that they would get same-day availability for those items put in the bank and next-day availability on all other deposits.

The premise of that was that we received local customer checks, people in the area usually who dealt with the banks in the area, so the checks were those local checks that were taken in.

To the extent we took in cash, that was added to the drawdown because we couldn't recapture the value of the cash the same day because we were using a check.

We automatically, in the drawdown program, assumed the check would be presented the next day for payment. If everything worked properly other than the cash deposit, there would never be an addition to drawdown because every check would clear the next day.

The account analysis is my way to review what the branch was doing, and more importantly, in my formula I left balances to pay for the services that the banks provided us. That basically was my system.

If you now want to ask me specifically, I will address that question in relation to my system.

Mr. McCollum. I can only ask you that, as I understand it, in a couple of the regions E.F. Hutton managers did more than that. They did what is called aggressive drawdowns. Apparently they violated, went beyond what your system stated.

Have you been following that? Are you aware of the details of that in any way?

I know you are not employed there now, and I am not asking you to vouch for the accuracy of what is being reported, but I am just curious, in general terms, if you could, if you have in your own mind thought about and could give us the benefits of those thoughts, where this aggressive overmanagement, if you will, may have differed from what you had intended?

Mr. Sullivan. Based on the information I have read in the papers and some of the documents I have seen, probably the most obvious item was an item called chaining, where branches seem to have been drawn down into other branches and then, subsequently, other branches. Those drawdowns deviated from the system of going to the region.

The regional bank is a strong bank. It will clear that check the next day because that is the way it is.

When you start to draw checks into other areas, the local bank then becomes the focal point to try to clear that check. So that as the checks got passed along from one bank to the next bank, it became much harder for the local bank to clear that check.

Now, using my formula and on the premise that we had next-day availability, you then could create excess balances, because the next morning when you did the formula you would take away yesterday's drawdown and then on Wednesday, if that were the next day, you would see that a check had not cleared.

Of course, the premise was that the bank had the balances and that was what was added to our drawdown.

So in the chaining effect, the bank that we were putting our deposits in, where we had led them to believe these would be local deposits, started receiving deposits from other locations.

Mr. McCollum. Because we have a vote on and in the interest of time, I will yield back. We may have a second round, I assume.

Mr. Hughes. Yes, we will.

Why don't we recess and catch our vote and come right back.

The subcommittee stands in recess for 10 minutes.

[Recess.]

Mr. Hughes. The subcommittee will come to order.

The Chair recognizes the gentleman from Florida for 5 minutes.

Mr. Smith. Thank you very much.

Mr. Sullivan, would you indicate again exactly when you began to devise this system, the original drawdown system?

Mr. Sullivan. The addition to drawdown?

Mr. Smith. No; the original drawdown system.

Mr. Sullivan. When I joined E.F. Hutton & Co., they had a drawdown system in place. That is, the branches were drawn down into the regions and the regions drawn down to New York.

Mr. Smith. You analyzed the system after you met with the bank president?

Mr. SULLIVAN. A banker from the west coast. That was in 1977. It was from that meeting that I started to review the branch bank accounts and regional bank accounts with account analysis.

Mr. SMITH. You determined there were further methods that could be employed to make regular use of existing funds; is that correct?

Mr. SULLIVAN. Mr. Chairman—excuse me, Mr. Congressman. What I had found was that the method of anticipating the deposits was incorrect, because tomorrow when they anticipated a deposit, they were, in effect, only putting a check in tomorrow and yet if they had anticipated that deposit and had drawn down the moneys when that check was presented the next day, that would have taken cash out of the bank. So that was an incorrect procedure that they were doing.

By the development of this addition to drawdown, we actually looked back in time, we actually looked at the deposits made that day and remembering that we always, prior to doing this program, had to check with the banks for availability of those deposits.

Mr. SMITH. In your testimony and in the meeting you had with the staff, it is indicated that back in 1974, you, together with a Mr. Ross met with house counsel from Hutton on the whole question because you thought that your cash management ideas might constitute check kiting. Is that correct?

Mr. SULLIVAN. No, sir. When I joined E.F. Hutton & Co. in 1974, my 10 years of security industry background was in the area of operations. I had successfully passed the various New York Stock Exchange and NASD exams. When I joined Hutton in 1974, they first put me in what they call their internal audit department. I spent about 6 or 7 weeks in internal audit, and during my review of the branches and in the Texas region during this audit, I had noted that many of the branches had closed their book balances with a negative figure. I discussed that with the various auditors I was on the project with, and they said that was not uncommon throughout the branches because the branches had earned intrabranch interest income by managing their money.

When I returned back to New York about 2 weeks later, I was offered a position with Hutton as a money manager. Bob Ross was my immediate boss. The first thing I had asked Mr. Ross was to review with him what I had discovered when I was doing internal auditings——

Mr. SMITH. Mr. Sullivan, we have a lot of ground to cover, and we have very little time and I cannot get expansive answers. I am trying to make my questions as specific as possible.

Did you or did you not meet with house counsel of Hutton about the whole drawdown question to seek advice as to whether or not there was any kind of check kiting that could be contemplated as a result of the drawdown system?

Mr. SULLIVAN. In 1974, I met with counsel, and they advised me that Hutton had the means and the ability to pay and that it was not check kiting.

Mr. SMITH. Did you seek such an opinion after you instituted your further drawdown modifications?

Mr. SULLIVAN. No, I did not, sir.

Mr. SMITH. Thank you.

This was a voluntary system, you testified a few minutes ago. When did it go into effect?

Mr. Sullivan. I introduced——

Mr. Smith. Not the first one now, the one that you enhanced.

Mr. Sullivan. I introduced it, I believe, in May 1978 at a regional operations managers' meeting.

Mr. Smith. It was done at a regional meeting?

Mr. Sullivan. That is correct.

Mr. Smith. It was advised—the system was laid out basically and they were told how they could implement it, correct?

Mr. Sullivan. That is correct.

Mr. Smith. Did that meeting receive in advance the blessing or had it been discussed with senior officials of Hutton?

Mr. Sullivan. I discussed that sheet with Mr. Ross, my immediate superior.

Mr. Smith. Who was the vice president of Hutton?

Mr. Sullivan. That is correct. I also would have spoken to Thomas Lynch who was our chief financial officer of the firm.

Mr. Smith. If I were to indicate to you that we had testimony here previously that no senior management ever agreed that this system should go into effect, would that be inconsistent with what your belief is?

Mr. Sullivan. I do not know who senior management was.

Mr. Smith. I am not asking you to speculate on that. If I told you that we had previous testimony that there had been no conscious decision of the upper corporate management level, at the level of Mr. Lynch, for instance, not mentioning that he had said it, but there was no decision to implement your additional enhancements to the drawdown system, would that be inconsistent with your understanding?

Mr. Sullivan. That would be correct, sir.

Mr. Smith. Who taught the branch managers how to run this system after you devised the enhancement procedures?

Mr. Sullivan. After it was introduced at the regional meeting, George Ball, who was the president of the firm, through a gentleman working for him named Peter Muratore, approached me at the end of 1978 and asked that in their training classes of assistant branch managers and branch managers if I would review Hutton's overall cash management program. One of the items that I covered was this addition to drawdown.

Mr. Smith. Did it ultimately become an element of training for branch managers and for money managers at the regional and branch level?

Mr. Sullivan. My speaking before that group would be the explanation of the money management system. I do not know if that was an actual item for them to do.

Mr. Smith. Would the system now have required additional people being hired in order to facilitate the collection of additional data and all the working that had to be done at the branch or region, phone calling in for bank balances and the like?

Mr. Sullivan. No, sir.

Mr. Smith. Now, let me ask you this. What was the date that you say that you left Hutton? And you indicated in your testimony a little while ago it was prior to the time that the system, which was now the subject of the investigation, began to develop in that form. What was the date that you say you left Hutton?

Mr. SULLIVAN. I resigned on May 6, 1980. I stayed on, on a volunteer basis, on a part-time basis, to the end of May. Mr. Morely was starting June 1.

Mr. SMITH. Let me ask you a question. Are you aware of—you said that you resigned May 6, but you never were present when that system began to create the kind of problems that were subsequently the basis of the investigation. Are you aware of a memo that went to George Ball from Mr. Tom Lillis on April 23, 1980 regarding two specific branches, Casper and Washington, DC?

Mr. SULLIVAN. No, sir.

Mr. SMITH. If Mr. Sullivan could be given a copy of exhibit 4, please, a memo dated April 23, 1980, to Ball from Lillis?

Mr. HUGHES. Lillis? Will the gentleman wish to put that in the record?

Mr. SMITH. Yes, for the record. Yes.

Mr. HUGHES. Without objection, so ordered.

[The information follows:]

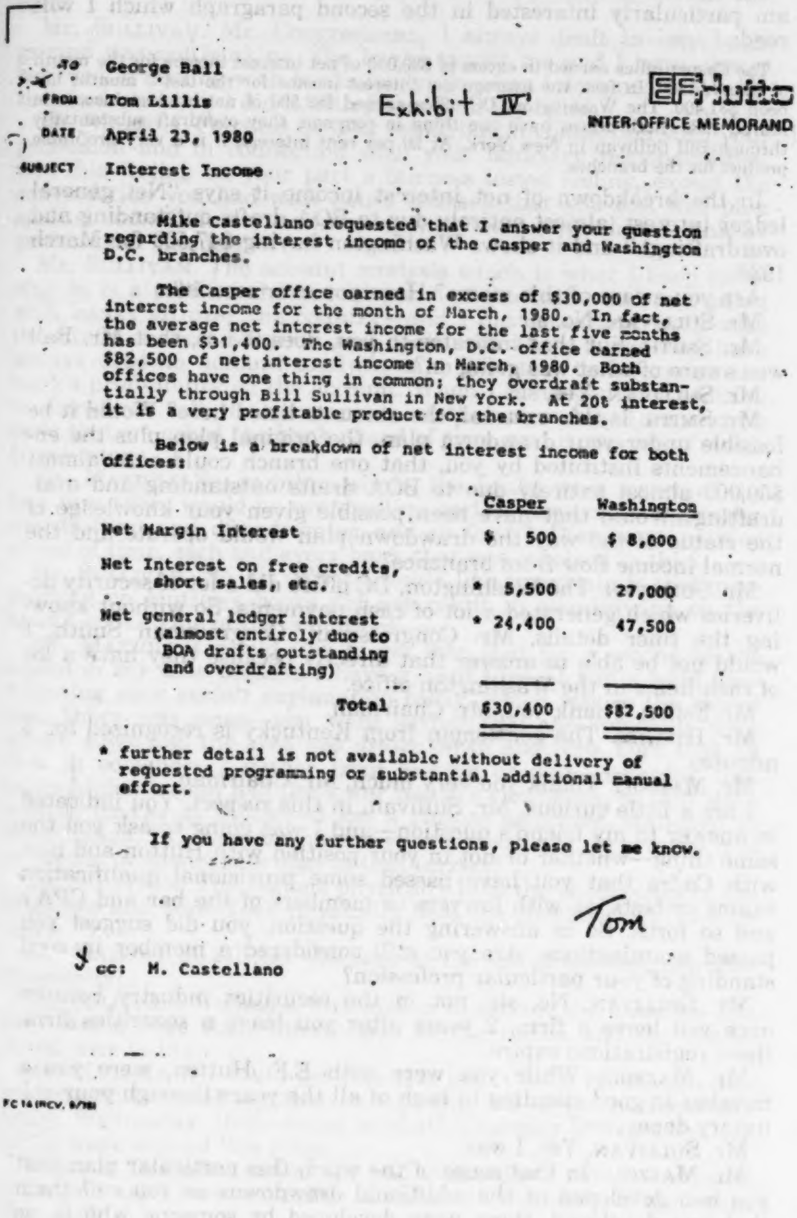


Exhibit IV

EFHutton
INTER-OFFICE MEMORANDUM

TO George Ball
FROM Tom Lillis
DATE April 23, 1980
SUBJECT Interest Income

Mike Castellano requested that I answer your question regarding the interest income of the Casper and Washington D.C. branches.

The Casper office earned in excess of $30,000 of net interest income for the month of March, 1980. In fact, the average net interest income for the last five months has been $31,400. The Washington, D.C. office earned $82,500 of net interest income in March, 1980. Both offices have one thing in common; they overdraft substantially through Bill Sullivan in New York. At 20% interest, it is a very profitable product for the branches.

Below is a breakdown of net interest income for both offices:

	Casper	Washington
Net Margin Interest	$ 500	$ 8,000
Net Interest on free credits, short sales, etc.	* 5,500	27,000
Net general ledger interest (almost entirely due to BOA drafts outstanding and overdrafting)	* 24,400	47,500
Total	$30,400	$82,500

* further detail is not available without delivery of requested programming or substantial additional manual effort.

If you have any further questions, please let me know.

Tom

cc: M. Castellano

FC 14 (REV. 8/78)

Mr. **SMITH.** This is an E.F. Hutton inner-office memorandum. I am particularly interested in the second paragraph which I will read:

> The Casper office earned in excess of $30,000 of net interest income for the month of March 1980. In fact, the average net interest income for the last 5 months has been $31,400. The Washington, DC office earned $82,500 of net interest income in March 1980. Both offices have one thing in common; they overdraft substantially through Bill Sullivan in New York. At 20 per cent interest, it is a very profitable product for the branches.

In the breakdown of net interest income it says "Net general ledger interest (almost entirely due to BOA drafts outstanding and overdrafting)," and it shows Washington having $47,500 for March 1980.

Are you aware of this memo? Have you ever seen it?

Mr. **SULLIVAN.** No, sir.

Mr. **SMITH.** But that indicates to you, does it not, that Mr. Ball was aware of what was going on?

Mr. **SULLIVAN.** Yes, sir.

Mr. **SMITH.** Is this unusual, the amounts listed here? Would it be feasible under your drawdown plan, the original plan plus the enhancements instituted by you, that one branch could earn almost $50,000 almost entirely due to BOA drafts outstanding and overdrafting? Would that have been possible given your knowledge of the status of the way the drawdown plan would operate and the normal income flow from branches?

Mr. **SULLIVAN.** The Washington, DC office did a lot of security deliveries which generated a lot of cash payments. So without knowing the finer details, Mr. Congressman, Congressman Smith, I would not be able to answer that directly because they have a lot of cash items in the Washington office.

Mr. **SMITH.** Thank you, Mr. Chairman.

Mr. **HUGHES.** The gentleman from Kentucky is recognized for 5 minutes.

Mr. **MAZZOLI.** Thank you very much, Mr. Chairman.

I am a little curious, Mr. Sullivan, in this respect. You indicated in answer to my friend's question—and I was going to ask you the same thing—whether or not in your position with Hutton and now with Cadre that you have passed some provisional qualification exams or tests, as with lawyers or members of the bar and CPA's and so forth. So in answering the question, you did suggest you passed examinations. Are you still considered a member in good standing of your particular profession?

Mr. **SULLIVAN.** No, sir, not in the securities industry because once you leave a firm, 2 years after you leave a securities firm, these registrations expire.

Mr. **MAZZOLI.** While you were with E.F. Hutton, were you a member in good standing in each of all the years through your voluntary departure?

Mr. **SULLIVAN.** Yes, I was.

Mr. **MAZZOLI.** In that sense of the word, this particular plan that you had developed or the additional drawdowns as you call them that you developed, those were developed by someone who is, as you were, in good standing in the profession, a fiduciary industry, and on that basis you felt this plan to be appropriate; is that correct?

Mr. **SULLIVAN**. Mr. Congressman, I always dealt in—my background was not banking. The banks taught me and I have always believed in dealing with banks fairly. So when I designed that addition to drawdown, I did it with fairness in my mind.

Mr. **MAZZOLI**. Fairness in your mind, but in connection with your profession and in connection with your fiduciary responsibilities, was this feeling on your part a fairness tested feeling, except the conversation you had with house counsel, that you test this plan against some industry norm or against some professional ethic or professional standard?

Mr. **SULLIVAN**. The account analysis which is what I keep referring to is a profit and loss statement of the bank, and in dealing with banks all over the country—and I did consulting work with the State of West Virginia and dealt with their banks—we have always used an account analysis as a fair item to determine the bank's profitability on the account. When I developed that addition to drawdown, all the components of that were based on certain facts that we asked the bank ahead of time, and it was again strictly voluntary.

Mr. **MAZZOLI**. So, in other words, the banks were aware of the fact that there would be overdrafting and in some cases aggressive overdrafting and drawdowning and so forth? They were notified ahead of time, each and every bank that was involved in this?

Mr. **SULLIVAN**. No, sir. What I would like to explain is that overdrafting on Hutton's books did not result in overdrawing on the bank's books. One of the conditions——

Mr. **MAZZOLI**. I would like to get into that for a second to the extent of my time because I have a hard time—I had a hard time following your earlier explanation today, which was to the extent that there was some—you were saying that the regionals were drawn down and the area was drawn down and New York took all that in somehow. I gather from looking at data yesterday that every higher region had the lower region's checkbook, so they were writing checks as though—I am a Hutton employee, stationed in Washington, DC, I do not have my own checkbook. In a sense it is in Boston or somewhere else. Is that correct?

Mr. **SULLIVAN**. The regions physically held the checkbooks of the branches and New York physically held the checkbooks of the regions.

Mr. **MAZZOLI**. So all this was done at the end of the day, like telephonically?

Mr. **SULLIVAN**. We had a wire system in each of the branches and they would wire their information to the region and the region would wire to the——

Mr. **MAZZOLI**. If I could get into this just a little bit though, the branch office would say that the—at the end of the business day today, Wednesday, that—today is what? Thursday. I forget the day of the week around this place.

Today is Thursday and at the end of the day I call the regional office and say I have a number of dollars in the bank. Is that what they did?

Mr. **SULLIVAN**. That is correct.

Mr. **Mazzoli.** Except that if I am not mistaken, you used this term "future availability". I not only tell my region I have this much in the bank, but I expect Larry Smith and John Jones to contribute to the E.F. Hutton branch tomorrow a million dollars, and I report that today, is that correct?

Mr. **Sullivan.** That was the previous system when they anticipated deposits, not in my system. Not in my system.

Mr. **Mazzoli.** You did not anticipate deposits?

Mr. **Sullivan.** No, sir.

Mr. **Mazzoli.** Yet under your system, more money was earned than was earned in the previous system.

Mr. **Sullivan.** Well——

Mr. **Mazzoli.** How could that be?

Mr. **Sullivan.** My system accurately recaptured the value of the money that was left with the bank. It did not guess, it did not estimate, and it put the right type of money in the right bank.

Mr. **Mazzoli.** If you didn't estimate—I think our chairman said there is a difference between sort of like wild guesses and accurate guesses, or calculated guesses.

But in any event, you are still anticipating money that isn't there in your hands and on that basis, a check is being written in Boston or New York or someplace on funds that are not only not in your possession, but are anticipated, is that correct?

Is it not anticipated?

Mr. **Sullivan.** No, sir. My formula recaptured the value of the money that already had been determined by calling the bank. There was no guesswork. It was actual moneys that had been identified as being left with the bank.

Mr. **Mazzoli.** Is what you just told me some sort of jargon for the industry? Am I missing something in this translation? Because if the previous system not only at the end of the day reported what your branches had on deposit, but what they expected they would get in tomorrow, which could be in the millions of dollars, but your system revised that no longer looking to tomorrow.

They were just looking to today. Yet your system made more money for Hutton. How does that, what I consider to be inconsistency, develop? Where does this extra interest earned come from?

Mr. **Sullivan.** It would come from actually analyzing your banks every single day.

Mr. **Mazzoli.** Analyzing my bank's what, their batting average on that?

Mr. **Sullivan.** No, no.

Mr. **Mazzoli.** How quickly they transfer checks, their float? What are you looking at at the bank. Assuming you are not looking to your clients to determine how much the clients will be contributing tomorrow, on Friday. What are you looking at today about the banks?

Mr. **Sullivan.** Let's start off with the Monday, so we can do a little example and I think that would clarify it.

If on a Monday, Hutton's books balance had to be zero and I won't bore the committee in explaining the availability. I would just say that that was a precondition. Hutton's book balance on Monday had to be zero. You take in your deposits for the day and say they took in $50,000.

That is the amount of money that they would report to the region to draw them down.

On the worksheet that I presented to the committee——

Mr. **Mazzoli**. Cash and checks, drafts?

Mr. **Sullivan**. That is correct; $50,000, and just so we don't complicate it, make it a check that becomes cash tomorrow; $50,000 is put in the account. They advise the region. The region draws them down. On Tuesday morning they would call their bank and ask for their opening balance. It would be $50,000.

On that worksheet they would put in $50,000, less the previous day's drawdown which was $50,000, and that would give them a zero addition to drawdown.

If it was Wednesday morning now, and nothing else happened on Tuesday, no moneys came in, when they called their bank their opening balance should be zero.

If it were $50,000, we would have recognized that the bank had good funds available on Tuesday. It was the value of that money that I recaptured and added to the drawdown.

Mr. **Mazzoli**. Well, again I don't want to—to go back to Monday, the zero balance on Monday, a $50,000 check comes in, it is deposited Monday afternoon in the bank, that is drawn down and the regional office takes it the same day, so the check in effect for $50,000 is deposited in yet another bank.

Mr. **Sullivan**. That is correct.

Mr. **Mazzoli**. It takes time for that check in New York to come back to Louisville, KY, for example, and in the meantime it might take 1 or 2 days so that money is still sitting in the bank, truthfully, I mean that is where it is. The bank would lend that out. Is that the idea?

So you are taking the interest the bank would have earned on that money, you are taking it for Hutton?

Mr. **Sullivan**. We are taking the value of Hutton's money for Hutton, that is correct.

Mr. **Mazzoli**. It is not your money, though. You have put the money in the bank in Boston and I assume you are drawing interest on that, so you are taking double interest, aren't you?

Mr. **Sullivan**. That hundred thousand is still in the bank or——

Mr. **Mazzoli**. But the worth of the money is being used twice. Once you are taking some interest on it because it has remained in Louisville, and yet at the same time you are obviously doing something with the bank in Boston, assuming that is where the region is. You are dealing with that bank and getting something—looks like what we learned in the church was the gifts of bilocation, you can be in two places at the same time.

You have two funds of $50,000 working to the benefit of E.F. Hutton at the very same moment.

Understand, you were not here at the earlier hearings and I have no brief for the banks on their float. They have driven a lot of companies like yours and others to these exotic and sometimes illegal schemes to try to recapture the value of their money.

But on the other hand, until that float system is done in the normal banking regulation phase, it seems to me you are trying to have your cake and eat it, too. Two funds, same check. How wrong am I?

Mr. **Sullivan**. Mr. Congressman, there are two things I would like to say to that.

No. 1, when we drawdown the check on Monday, that is what we call a clearinghouse funds deposit since it is not cash until Tuesday.

We take that money in, and in the case of Kentucky, I assume it would have been drawn down by Chicago, because that may have been the region rather than New York.

The premise is that the regional bank being a big bank, would clear that check tomorrow against the bank in Kentucky. But if it did not clear that check against the bank in Kentucky, Hutton would have cash in one bank, and still have cash——

Mr. **Mazzoli**. Let me ask you this, Mr. Sullivan. Assuming that Chicago called New York and they said, we have $50,000 on deposit among other things from Kentucky, so then New York was writing a check that very same day for $50,000 on Chicago and Chicago wrote it on Louisville. In that sense of the word, it took a while for the check to come from New York back to Chicago or through the Fed system to Louisville.

So in a way, as the term goes, you are kiting this thing and it keeps going up and up and up and every regional and branch area is benefiting from a fund of $50,000 which exists only at one place, at one time, in this world of ours.

Mr. **Sullivan**. What has happened, the drawdown mechanism was the branch to the region, there were a lot of branches and they could be drawn down most effectively into the region. The regional bank is in a better position to clear the checks against the local branch.

Mr. **Mazzoli**. My time has expired, Mr. Sullivan. I guess we could go in this rondelet for a while. Let me sum up what I said at the start.

As a professional, a person who has worked as a trustee, a fiduciary—as a person with your company advising institutions like universities and others on how to manage their money—are you satisfied, are you comfortable in having to explain this to this committee and to this country?

Mr. **Sullivan**. Mr. Congressman, I have spoken——

Mr. **Mazzoli**. I didn't ask you that, I know you have spoken many times and——

Mr. **Sullivan**. I am satisfied.

Mr. **Mazzoli**. You are comfortable?

Mr. **Sullivan**. Yes.

Mr. **Mazzoli**. You find nothing awkward or difficult in this, you don't find any nerve that might be jangling just a little bit to say, gee, it does sound, when you really explain this, a little bit like a scheme or a hoaxed up affair. Nothing like that obviously strikes you? You are totally satisfied, completely comfortable telling us about this arrangement?

Mr. **Sullivan**. More than anybody in this room, I spend every day working with banks and I am satisfied, sir, with my system.

Mr. **Mazzoli**. Thank you.

Thank you, Mr. Chairman.

Mr. **Hughes**. Before recognizing the gentleman from Connecticut, I just want to say there are a lot of things that I find fascinating, but the witness suggests that he wanted to be abundantly fair with the banks. The banks were not privy to these arrangements. That was a unilateral step on the part of E.F. Hutton to try to recapture what they felt the bank had in their accounts.

The banks were never privy to this—except when they found out about it—and they made complaints.

Mr. **Mazzoli**. And demanded money back, and so they didn't think that was a very good scheme.

Mr. **Hughes**. The gentleman from Connecticut.

Mr. **Morrison**. Thank you, Mr. Chairman.

I want to go back to documents that raise questions about the matter the chairman just alluded to, the comfort of the banks in this situation, for example, and the degree to which—let me ask you this first. Do you acknowledge that the system that you put in place was ultimately abused and resulted in improper and illegal practices?

Mr. **Sullivan**. That is correct.

Mr. **Morrison**. So there is no question that regardless of how you conceived of this, it did get out of hand, even by the standards that we might or might not agree that your system was fair to start with, but it certainly went beyond the bounds that were proper; you agree with that?

Mr. **Sullivan**. Yes, sir.

Mr. **Morrison**. One of the questions is the extent to which you and others were aware of that along the way rather than unaware. And your position as I understand is that you were not aware of excessive or abusive use of your system?

Mr. **Sullivan**. That is correct, sir.

Mr. **Morrison**. OK.

Now, I would like to show you a document dated August 3, 1979, which is a letter from Manufacturers Hanover Trust Co., and the writer in that letter talks about problems and also makes reference to the, similar to the collected balance problem of May. In other words, a repetition of what the bank viewed as excessive overdrafting, that you were not maintaining sufficient balances to cover what they thought was appropriate to make their transactions with you profitable or at least covering their costs.

Would you take a look at that letter.

Mr. **Sullivan**. Thank you very much.

Mr. **Morrison**. And tell me whether you recall it in any way and what the situation was.

Mr. **Hughes**. Does the gentleman intend to offer that for the record?

Mr. **Morrison**. Yes.

Mr. **Hughes**. Without objection, so ordered. It will be received for the record.

The witness will respond.

Mr. **Morrison**. Mr. Chairman, if I could offer also the July 25, 1979, letter from Mr. Puccia at Manufacturers Hanover Trust and the attachment in terms of a billing we could have the witness look at all three of those.

Mr. **Hughes**. That is the letter of July 25 directed to William Sullivan from Vincent Puccia. And the attachment?

Mr. **Morrison**. And the attached July 1979 billing.

Mr. HUGHES. Without objection, so ordered.

[The documents referred to follow:]

MANUFACTURERS HANOVER TRUST COMPANY

40 WALL STREET, NEW YORK, N.Y. 10015

Jon
Please Adv

August 3, 1979

Mr. William T. Sullivan, Jr.
Vice President
E. F. Hutton & Co., Inc.
One Battery Park Plaza
New York, New York 10004

Dear Bill:

Similar to the collected balance problem of May, we appear to have a more serious problem in June.

Attached is a two-part analysis of your accounts. One reflects collected balances prior to services and the other after services.

	Before Services	After Services
140-0-80209	$(15,926,584)	$(17,053,852)
0-81914	71,053	—
0-90618	29,058,070	28,894,740
0-92525	(1,655,354)	(1,671,740)
0-94408	(19,989,632)	(19,992,168)
NET	$ (8,442,447)	$ (9,823,020)

If I can assist you in any way, please let me know.

Regards.

Very truly yours,

Vincent S. Puccia
Assistant Vice President

Enclosures

cc: Stephen V. B. Goodhue, S.V.P. - 9/44
Jack Born - 9/44

MANUFACTURERS HANOVER TRUST COMPANY

40 WALL STREET, NEW YORK, N.Y. 10015

July 25, 1979

Mr. William Sullivan, Jr.
Vice President
E. F. Hutton & Co., Inc.
One Battery Park Plaza
New York, New York 10004

Dear Bill:

Our analysis for May indicates a rather extensive use of federal funds. I would appreciate it if someone in your area could review this to see what the problem or problems might be.

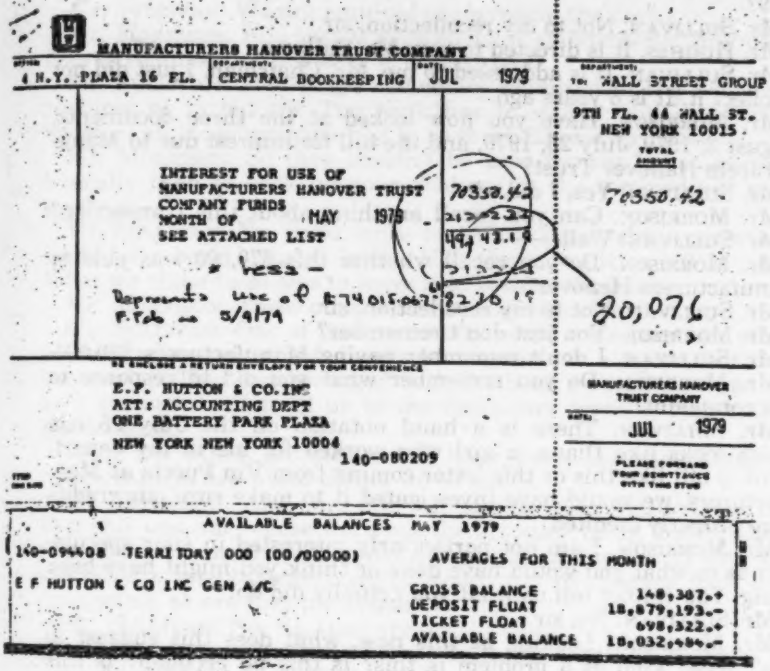
Hope all is well with you.

Very truly yours,

Vincent S. Puccia
Assistant Vice President

Enclosure

Pris
Lee McDill 7-26



MANUFACTURERS HANOVER TRUST COMPANY

OFFICE: 4 N.Y. PLAZA 16 FL.
DEPARTMENT: CENTRAL BOOKKEEPING
DATE: JUL 1979

INTEREST FOR USE OF
MANUFACTURERS HANOVER TRUST
COMPANY FUNDS
MONTH OF MAY 1979
SEE ATTACHED LIST

70350.42
21,[illegible].22
49,43[illegible].19

* less -
Represents use of $74015067 8270.19
F.Fds on 5/9/79

WE ENCLOSE A RETURN ENVELOPE FOR YOUR CONVENIENCE

E.P. HUTTON & CO.INC
ATT: ACCOUNTING DEPT
ONE BATTERY PARK PLAZA
NEW YORK NEW YORK 10004

140-080209

DEPARTMENT
TO: WALL STREET GROUP
9TH FL. 44 WALL ST.
NEW YORK 10015

TOTAL AMOUNT
70350.42 -
20,076 >

MANUFACTURERS HANOVER TRUST COMPANY
DATE: JUL 1979
PLEASE FORWARD YOUR REMITTANCE WITH THIS STUB

AVAILABLE BALANCES MAY 1979

140-094408 TERRITORY 000 (00/00000)
E F HUTTON & CO INC GEN A/C

AVERAGES FOR THIS MONTH

GROSS BALANCE	148,307.+
DEPOSIT FLOAT	18,879,193.-
TICKET FLOAT	698,322.+
AVAILABLE BALANCE	18,032,484.-

Mr. **Morrison**. If the staff could show that to Mr. Sullivan.

Mr. **Hughes**. Is the witness familiar with the letter of August 3, 1979?

Mr. **Sullivan**. Not to my recollection, sir.

Mr. **Hughes**. It is directed to you, Mr. Sullivan.

Mr. **Sullivan**. It is addressed to me, Mr. Chairman, I just did not recollect it. It is 6 years ago.

Mr. **Morrison**. Have you now looked at the three documents, August 3, 1979, July 25, 1979, and the bill for interest due to Manufacturers Hanover Trust?

Mr. **Sullivan**. Yes, I did, sir.

Mr. **Morrison**. Can you recall anything about this transaction?

Mr. **Sullivan**. Well——

Mr. **Morrison**. Do you recall whether this $70,000 was paid to Manufacturers Hanover?

Mr. **Sullivan**. Not to my recollection, sir.

Mr. **Morrison**. You just don't remember?

Mr. **Sullivan**. I don't remember paying Manufacturers $70,000.

Mr. **Morrison**. Do you remember what you did in response to this complaint?

Mr. **Sullivan**. There is a hand notation on the July 25 one which looks like Diana, a girl who worked for me in my department, a bill like this or this letter coming from Vin Puccia at Manufacturers, we would have investigated it to make sure our credits were properly credited.

Mr. **Morrison**. I am not particularly interested in your speculation as to what you would have done or think you might have been doing. You cannot tell us what you actually did do?

Mr. **Sullivan**. No, sir.

Mr. **Morrison**. Looking at this now, what does this suggest to you? What kind of a problem is this? Is this no problem? Is this what you would have expected to have heard from Manufacturers Hanover as a result of your system? Or is this some kind of aberration of your system and if so, what would this have told you from your knowledge of your system?

Mr. **Sullivan**. Mr. Congressman, the Manufacturers Hanover Trust Co. bank account that we maintained did not or was not involved in the addition to drawdown. That was, the addition to drawdown sheet was given to the branch offices. This is our main operating account at Manufacturers which is where all the funds of the firm are transferred in and all payments made out of.

Mr. **Morrison**. This includes your zero balance account in this list, looking at the August 3 letter.

Mr. **Sullivan**. There is on the August 3 letter, what we had—what we had was a CEA offset account.

Mr. **Morrison**. If we can get into that a minute.

Is one of these the CEA account?

Mr. **Sullivan**. Yes, sir.

Mr. **Morrison**. Is that the one with the $29 million in it?

Mr. **Sullivan**. $29 million versus the $28 million, yes, sir.

Mr. **Morrison**. That is the CEA account. That is a segregated fund that you are required to keep as a result of securities regulations; is that correct?

Mr. **Sullivan**. Commodity regulations, yes, sir.

Mr. MORRISON. OK. In other words, that—you are required to keep a post balance there?

Mr. SULLIVAN. We are required to segregate the cash.

Mr. MORRISON. And that is as security or collateral for your dealings in commodities markets, is that correct?

Mr. SULLIVAN. That is the customary requirement the Exchange requires us to put up. The bank has to sign a no-right-of-offset letter so all those accounts had to have a CEA waiver letter.

Mr. MORRISON. So they couldn't be used for any other purpose basically than to back up your dealings in the commodities markets?

Mr. SULLIVAN. No; those funds under the commodity regulations could have been invested in the U.S. Government or left in cash. What we chose to do was to leave it in cash at the bank.

Mr. MORRISON. These other accounts are what then?

Mr. SULLIVAN. One of those accounts would have been our offset account where we would always be negative as a figure, but zero book value. That was arranged with the bank's permission and we kept customer collateral up in the depository transfer corporation for the bank.

Then the other account would have been the main account where moneys are wired in and wired out.

Mr. MORRISON. And you, are you saying when you said earlier that this was not—these were not the accounts being drawn down, this was your main bank account, was one of the things you just described a zero balance account where you reimbursed back into the system, or are they not related to that?

Mr. SULLIVAN. No, sir, they are not.

Mr. MORRISON. One more time; Is there anything unusual in your being $8,000 or $9,000 to the negative here? Is that an expected or usual practice?

Mr. SULLIVAN. No, sir, we should not be negative.

Mr. MORRISON. But this had no relationship whatever to the drawdown system?

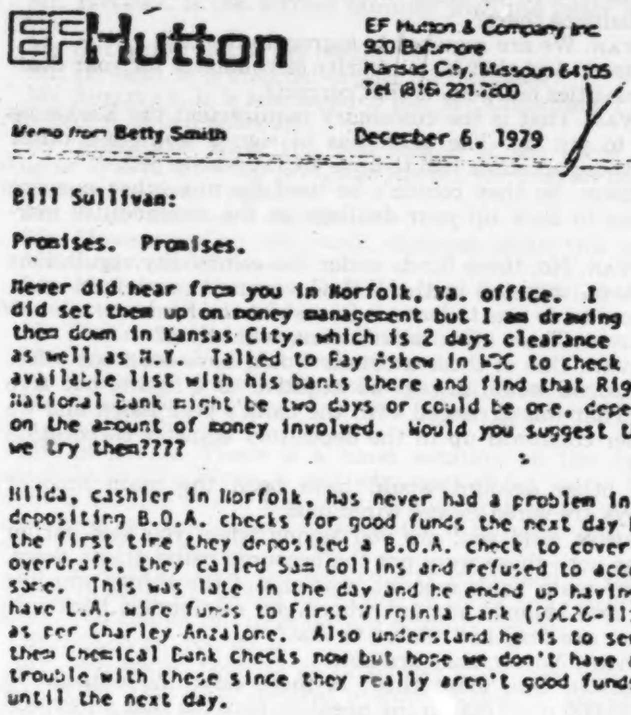
Mr. SULLIVAN. No, sir, it did not.

Mr. MORRISON. Let me direct your attention to another document.

Mr. Chairman, if I could, the note from Betty Smith dated December 6, 1979, to Bill Sullivan. If that could be entered in the record.

Mr. HUGHES. Without objection, so ordered.

[The letter referred to follows:]



EFHutton

EF Hutton & Company Inc
920 Baltimore
Kansas City, Missouri 64105
Tel (816) 221-7800

Memo from **Betty Smith**

December 6, 1979

Bill Sullivan:

Promises. Promises.

Never did hear from you in Norfolk, Va. office. I did set them up on money management but I am drawing them down in Kansas City, which is 2 days clearance as well as N.Y. Talked to Ray Askew in WDC to check available list with his banks there and find that Riggs National Bank might be two days or could be one, dependi on the amount of money involved. Would you suggest that we try them????

Hilda, cashier in Norfolk, has never had a problem in depositing B.O.A. checks for good funds the next day but the first time they deposited a B.O.A. check to cover overdraft, they called Sam Collins and refused to accept same. This was late in the day and he ended up having t have L.A. wire funds to First Virginia Bank (9026-1100) as per Charley Anzalone. Also understand he is to send them Chemical Bank checks now but hope we don't have any trouble with these since they really aren't good funds until the next day.

Sam decided to stop overdrafting until all of the probl were resolved. This bank is right across the hall from them so naturally they want to do business with them.

PLEASE give me your ideas on the above and give me a ca

Thanks,

Mr. Morrison. If it could be shown to the witness.

Mr. Hughes. A document from Betty Smith of E.F. Hutton, December 6, 1979, to Bill Sullivan.

Mr. Morrison. Making mention of problems with the Norfolk office.

Mr. Hughes. Starts off, "Promises. Promises."

Mr. Morrison. That is correct.

Mr. Hughes. Have you seen this document before, Mr. Sullivan?

Mr. Sullivan. It has my name on it so I must have seen it back in 1979.

Mr. Morrison. Well, do you recall seeing it? You answered the chairman you must have. You don't have any recollection of it at the present time? Have you seen it since 1979? Have you reviewed it in the process of consideration of this case at any time?

Mr. Sullivan. I just saw this particular document about 36 hours ago, sir.

Mr. Morrison. In that context where did you see it?

Mr. Sullivan. In my attorney's office.

Mr. Morrison. This seems to be a discussion of a problem that arose in the implementation of your drawdown system. Would you agree with that?

Mr. Sullivan. Betty is writing to me and the addition to drawdown was premised on the getting of 1-day availability on all deposits.

What she is saying to me in an ongoing——

Mr. Morrison. You say it was based on the premise that that is what would occur in your bank from which you made the drawdown—from which you drew down; is that correct?

Mr. Sullivan. No, the premise on which we asked the banks to give us 1-day availability.

Mr. Morrison. They are not required to do that.

Mr. Sullivan. If they don't give us 1-day availability, you cannot do that part of the addition to draw down.

Mr. Morrison. In other words, the 1-day availability was your desire from the banks. It was not their legal obligation to give you 1-day availability?

Mr. Sullivan. The 1-day availability, if banks had an option they would give us 5 days.

Mr. Morrison. I understand that, but one of the things we are dealing with is the extent to which you had—of this whole good relationship with the banks, you didn't do anything the banks disagreed with, you say, but this seems to be a discussion of the fact that you had a whole system premised on 1-day availability, which wasn't the fact.

Mr. Sullivan. That is right.

Mr. Morrison. And gave rise to problems, is that right?

Mr. Sullivan. In this example, yes, and she changed over to a Chemical Bank deposit because that was 1-day availability.

Mr. Morrison. What are we to understand from the introduction of this letter, "Promises. Promises." What are the promises not being kept?

Mr. Sullivan. I believe Ms. Smith had come to New York in November and I took her to a show called "Promises. Promises." And I just assumed that that is how she started it off.

Mr. **Morrison**. I think we will leave that one alone.

The only other question I have with respect to this is that—did this give rise to any concern about your system of systematically overdrafting in other circumstances like in violation of what the banks were actually giving in terms of availability?

Mr. **Sullivan**. The account analysis that I keep referring to was an important ingredient. I have never said that that addition to rawdown system was a concrete item. It was voluntary and it needed the cooperation of the banks.

The branch had to ask the bank for that availability schedule. In this particular case, in doing the program she noted, there was a problem and we corrected the problem. Cash management is not set in concrete. It changes every day.

Mr. **Hughes**. The gentleman's time has expired.

The gentleman from California.

Mr. **Lungren**. No questions, Mr. Chairman.

Mr. **Hughes**. Mr. Sullivan, just continuing with the correspondence, I am going to ask staff to show you a copy of a letter to you dated March 28, 1980 from a Judith S—looks like Spafford, assistant vice president, First National Bank of Kansas City.

Are you familiar with that letter?

Mr. **Sullivan**. May I have a moment to read it, sir?

Mr. **Hughes**. Sure, go ahead.

Mr. **Sullivan**. Mr. Chairman.

Mr. **Hughes**. Are you familiar with the document?

Mr. **Sullivan**. Yes, I am now. This letter that I received from Judith Spafford as it notes, is a followup to my conversation to her. We were running our account analysis showing that for a few-month period, that this bank was not properly compensated. Earlier in today's hearing you gave me a copy of a letter, a memorandum from me to Michael Goldstein. In both cases, cash management at Hutton was an ongoing item. That was my job 8 hours a day.

I had conversation with this bank and I asked the bank to please analyze our account and what you are about to see here was that she examined our account for a 5-day period. The premise of our system was same day availability and cash the next day.

She points out to us that many of our deposits are made at 2:30 to 4 o'clock each afternoon, their bank's cutoff time, if I remember correctly, was 2 o'clock. So what was happening was that every deposit we made, even though we should have had same day money on checks drawn on the bank and cash the next day, was eliminated because we missed the bank's cutoff time.

She was kind enough to go through this analysis and say that there were items here that were given to them by out-of-state items, and that some of the actual deposits weren't 1 day, approximately 5 percent of the deposits were 2 days.

Mr. **Hughes**. What is meant by the statement, "I am sending you these reports so that you can examine the transit routings that are included in the daily deposits."

What is she saying there?

Mr. **Sullivan**. She was referring to the deposits of the branch offices in the region, the Kansas region, Mr. Chairman.

Mr. HUGHES. I ask you to look—without objection, I will offer that for the record.

[The letter referred to follows:]

Mr. William T. Sullivan
Vice President
EF Hutton & Company, Inc.
One Battery Park Plaza
New York, New York 10004

Dear Bill:

[illegible]

[illegible]

[illegible]

Sincerely,

[illegible]
Assistant Vice President

[illegible]

March 28, 1980

Mr. William T. Sullivan
Vice President
EF Hutton & Company, Inc.
One Battery Park Plaza
New York, New York 10004

Dear Bill:

As a follow-up to our conversations regarding the float on the EF Hutton regular account, I have analyzed a five-day period and have found the following results. These figures represent deposits from March 3 through March 7.

During that five-day period, several factors came to light, the first factor being that the deposits are being made between 2:30 and 4:00 p.m. each afternoon. Secondly, I noted that on almost everyday, there were at least four separate deposits representing incoming checks as well as the transfers; and thirdly, in the regular deposit, I noted that on the average, approximately five percent of the dollars were two-day availability. All of these factors are indicated in the attached Deposit Analysis by F&B Number reports. I am sending you these reports so that you can examine the transit routings that are included in the daily deposits. For example, there are a number of items from Topeka and Wichita, Kansas; several from St. Joseph, Missouri; and various other points, such as Boston, New York, Denver, etc. Because of the late deposit, these items are picking up additional float.

Bill, I hope this helps in your analysis of the activity at First National Bank. If there is further information that I can provide you, please do not hesitate to contact me.

Sincerely,

Judy

Judith A. Spafford
Assistant Vice President

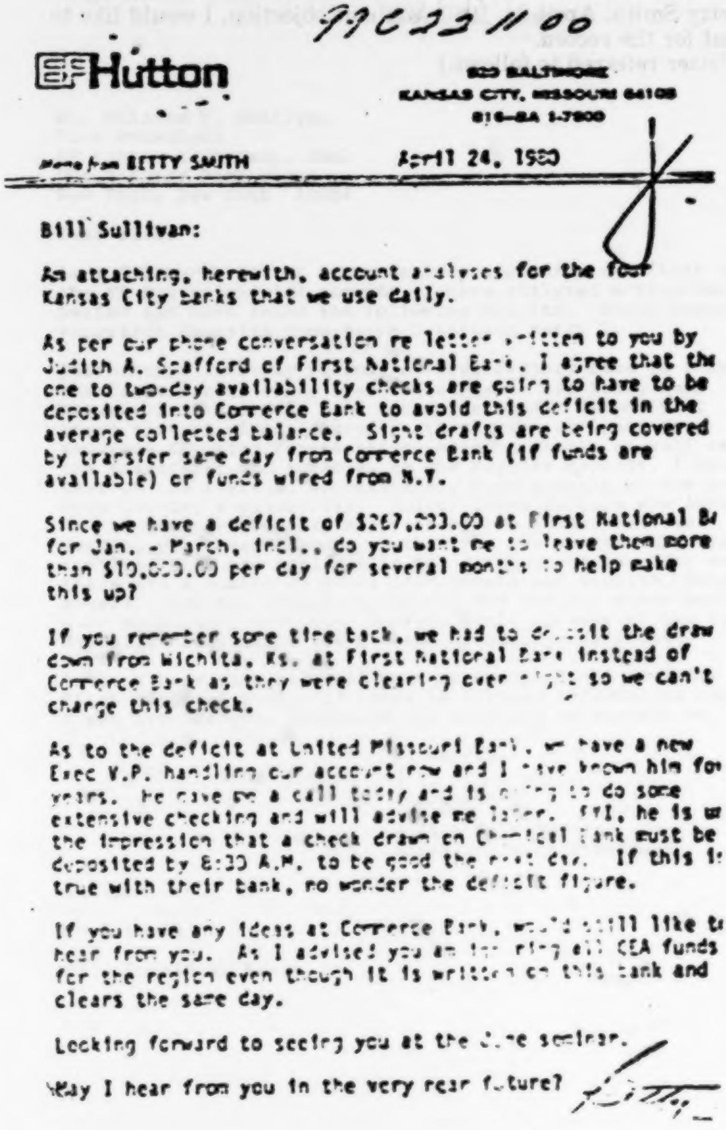
JAS:pm

Enclosures

cc: Donald H. Kasle

Mr. **Hughes**. Let me ask you to examine another memo, again from Betty Smith, April 24, 1980. Without objection, I would like to offer that for the record.

[The letter referred to follows:]



99C23 1100

EFHutton

920 BALTIMORE
KANSAS CITY, MISSOURI 64105
816—BA 1-7900

Memo from BETTY SMITH April 24, 1980

Bill Sullivan:

Am attaching, herewith, account analyses for the four Kansas City banks that we use daily.

As per our phone conversation re letter written to you by Judith A. Spafford of First National Bank, I agree that the one to two-day availability checks are going to have to be deposited into Commerce Bank to avoid this deficit in the average collected balance. Sight drafts are being covered by transfer same day from Commerce Bank (if funds are available) or funds wired from N.Y.

Since we have a deficit of $267,233.00 at First National B for Jan. - March, incl., do you want me to leave them more than $10,000.00 per day for several months to help make this up?

If you remember some time back, we had to deposit the draw down from Wichita, Ks. at First National Bank instead of Commerce Bank as they were clearing over night so we can't charge this check.

As to the deficit at United Missouri Bank, we have a new Exec V.P. handling our account now and I have known him fo years. He gave me a call today and is going to do some extensive checking and will advise me later. FYI, he is u the impression that a check drawn on Chemical Bank must be deposited by 8:30 A.M. to be good the next day. If this i true with their bank, no wonder the deficit figure.

If you have any ideas at Commerce Bank, would still like t hear from you. As I advised you am funneling all CEA funds for the region even though it is written on this bank and clears the same day.

Looking forward to seeing you at the June seminar.

May I hear from you in the very near future? Betty

Mr. HUGHES. I would ask you if you recall that memo. Have you seen that memo before?

Mr. SULLIVAN. About 36 hours ago, Mr. Chairman.

Mr. HUGHES. Once again, in the context of your attorney's office reviewing this matter?

Mr. SULLIVAN. Yes, sir.

Mr. HUGHES. I see.

What is meant by the third paragraph, since we have—referring to average collected balance—at First National Bank for January and March—there is a deficit of some 267,000 dollars—and the question is asked, should we leave more than $10,000 per day to help make up for apparently the deficiencies. The overdrafting, I presume.

Mr. SULLIVAN. The ongoing relationship with this particular bank, when Betty wrote this memorandum to me, a means to compensate a bank would be to leave them more dollars than the $10,000.

Mr. HUGHES. Why compensate the bank? My question is what is the meaning of that? That is the question.

Mr. SULLIVAN. Well, for the January and March period they had examined the account and found out what the problems were, about this 2:30 and 4 o'clock problem, and it was because of that problem they created a negative balance.

Mr. HUGHES. Doesn't that suggest to you there is overdrafting going on there?

Mr. SULLIVAN. Excuse me.

Mr. HUGHES. Doesn't that suggest there was overdrafting of the account?

Mr. SULLIVAN. No, sir; What it shows is that there was a problem in the account and we asked the bank to examine that problem, and they said it was the time of the day that we were making our deposits and we corrected that.

Mr. HUGHES. Well, what caused the problem?

Mr. SULLIVAN. They were making the deposits between 2:30 and 4 o'clock and the bank's 2 o'clock was their cutoff. The bank was open, they made their deposits, but to get the availability that I have mentioned, many times they had to make that deposit by 2 o'clock.

Mr. HUGHES. You obviously were attempting to compensate in some way the bank for the bank's loss of interest income

Going back to Manufacturers Trust; the memo my colleague from Connecticut put in, we are talking about $9.8 million average daily uncollected balance for 1-month. How much in interest income does that represent? Or loss to the bank, on the other hand?

The interest rate was about 15 percent at that time.

Mr. SULLIVAN. 1979? I don't know, Mr. Chairman. But it would have——

Mr. HUGHES. $125,000 is a pretty good estimate of the loss to the bank, and the gain to E.F. Hutton? Is that correct?

Mr. SULLIVAN. You would have to divide that by 12, is that correct? You are looking for 1 month. This is a 1-month analysis.

Mr. HUGHES. Yes; 1 month.

Mr. SULLIVAN. It would be about $10,000.

Mr. **Hughes**. $9.8 million, times 15 percent times one-twelfth?

Mr. **Sullivan**. $10,000, about $10,000.

Mr. **Hughes**. It is over a $100,000, isn't it?

Mr. **Sullivan**. About $120,000.

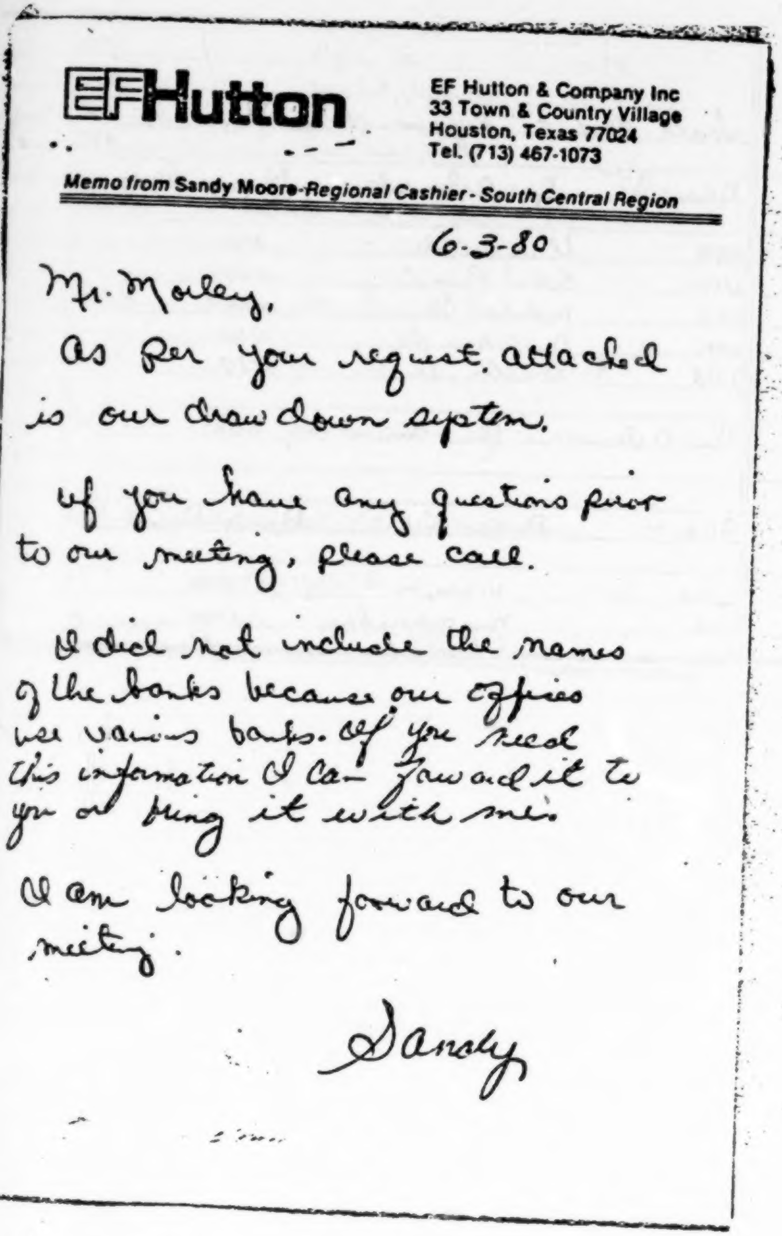
Mr. **Hughes**. So my estimate of $125,000 is about right.

You see your testimony was that you were not on notice in any time that you were the Money Mobilizer, that the banks were unhappy with some of the practices of E.F. Hutton.

And the documents that we have provided for you today demonstrate that you did have problems with the banks. It also is your testimony that you were not familiar with chaining, and I ask you if you would look at another document I am going to offer for the record, a memorandum from Sandy Moore, regional cashier, south central region, dated June 3, 1980, with attachments directed to Mr. Morley from Sandy.

I ask you if you are familiar with that memo.

[The documents referred to follow:]



EF Hutton

EF Hutton & Company Inc
33 Town & Country Village
Houston, Texas 77024
Tel. (713) 467-1073

Memo from Sandy Moore-Regional Cashier - South Central Region

6-3-80

Mr. Morley,

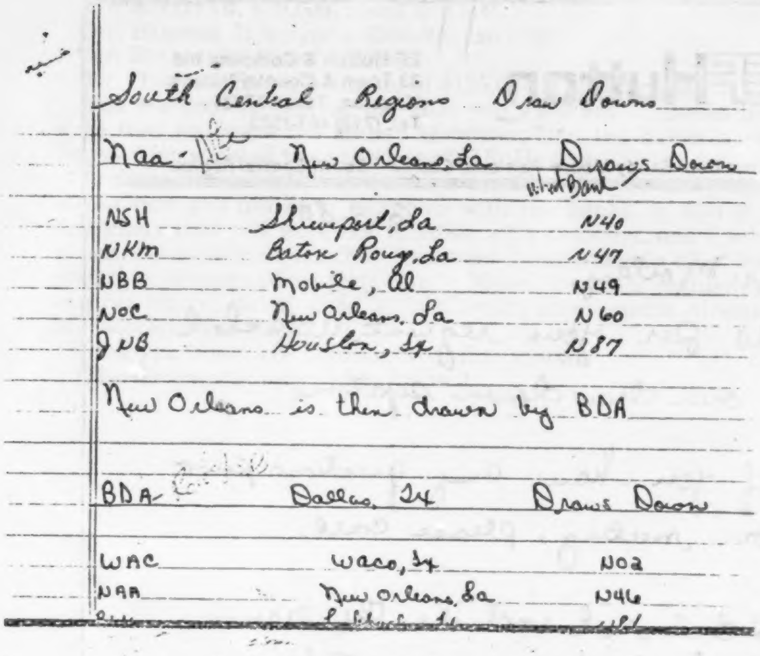
As per your request, attached is our draw down system.

If you have any questions prior to our meeting, please call.

I did not include the names of the banks because our offices use various banks. If you need this information I can forward it to you or bring it with me.

I am looking forward to our meeting.

Sandy

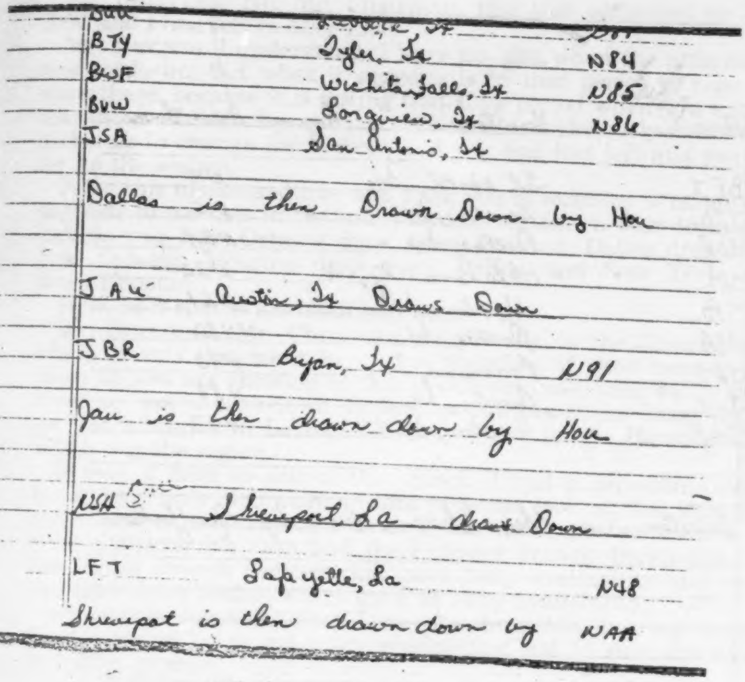


South Central Regions Draw Downs

Naa-	New Orleans, La	Draws Down What Bank
NSH	Shreveport, La	N40
NKM	Baton Roug, La	N47
NBB	Mobile, Al	N49
NOC	New Orleans, La	N60
JNB	Houston, Tx	N87

New Orleans is then drawn by BDA

BDA-	Dallas, Tx	Draws Down
WAC	Waco, Tx	N02
NAA	New Orleans, La	N46
[illegible]	[illegible]	[illegible]



BTY	Tyler, Tx	N84
BWF	Wichita Falls, Tx	N85
BVW	Longview, Tx	N86
JSA	San Antonio, Tx	

Dallas is then Drawn Down by Hou

JAU Austin, Tx Draws Down

JBR	Bryan, Tx	N91

Jau is then drawn down by Hou

USA Shreveport, La draws Down

LFT	Lafayette, La	N48

Shrevepot is then drawn down by NAA

Allied

Hou	Houston - Region	Draw Down
BFT	Ft Worth, Tx	N14
JTD	Houston, Tx	N05
BDP	Dallas, Tx	N34
OKL	Oklahoma City, OK	N32
JPO	Houston, Tx	N61
BDA	Dallas, Tx	N82
JBT	Beaumont, Tx	N90
JAK	Austin, Tx	N89
JGR	Houston, Tx	N93

Houston is then drawn down by New York

Mr. SULLIVAN. No; Mr. Chairman, this was addressed in June 1980 and I had left in May 1980.

Mr. HUGHES. I understand. I have no idea when the attachment was made up. But what it suggests is in that period of time you were there, because it is during that time period when you were in transition, Mr. Morley was just on board, and obviously didn't have a chance to change the system, and you had just left and you had set up the system.

Now, this memorandum—and I ask you to examine it carefully—suggests to me that in the south central region, on drawdowns, the process was New Orleans drew down Houston, Dallas drew down New Orleans, Houston drew down Dallas, and New York drew down Houston.

Now, as if that is not chaining, what is it?

Mr. SULLIVAN. Mr. Chairman, specifically in the Texas region which is this document here, the branches, if they were drawn down as you are showing in this document here, that would be to speed up, not to slow down. In fact, specifically in the Texas region, we had a branch in Loving, TX, draw down by the Houston office which was the region.

It took 2 days to collect that check. I had a representative of Bank America's cash management program look at that item, and came back to me and said that in Texas, there are two Federal Reserve districts. We then had the Lubbock branch drawn down by the Dallas Branch because that gave 1-day availability and Houston drew down Dallas, which gave us 1-day availability.

From this document that I see, the branches drawing down a branch would be to get 1-day availability, not to slow down that collection process.

Mr. HUGHES. Why would it—why would, however, New Orleans draw down Houston and Houston ultimately again draw down Dallas? What is the——

Mr. SULLIVAN. Houston is the region, so everything would go to Houston.

Mr. HUGHES. As I understood the system that you set up, the region would draw down the branches.

Mr. SULLIVAN. That is correct.

Mr. HUGHES. But in this scenario according to this memo, that was—it was not going directly to the region. It was going from Houston to New Orleans, from New Orleans to Dallas, from Dallas then back to the region, back to Houston.

Mr. SULLIVAN. The only item on this list is the Houston, TX, one that would go opposite that statement of having the branches draw down by the region. I believe they had Houston draw down by New Orleans because the Houston branch was also the region's branch and that check was clearing on them the same day since the bank would clear a check drawn on itself the same day.

So the Houston item was drawn down by another branch.

Mr. HUGHES. Well,——

Mr. MAZZOLI. Mr. Chairman. Could I ask?

Mr. HUGHES. Yes.

Mr. MAZZOLI. That gets back to what I talked to Mr. Sullivan about, that is the kiting where you get from A to Z through all the intermediary letters. I will accept that this arrangement in Texas was meant not to slow down which I assume is what chaining is supposed to do, but in fact, to expedite which is your cash management system. But am I not correct that every time you have an intermediary transaction, that that enables that $50,000—to go back to our example—that enables that $50,000 to take on new identity in each and every one of those depository institutions which suggests that if this form, this management form, is retained and done at every level, the branch, the region, at the other offices, every single one of them is calling their banks the next morning and finding out what is my balance and each and every time they are, that gives them a creative opportunity to finagle money out of the banks by using that money for free.

And gaining interest on it.

So it seems to me that while there may have been an effort to quickly move these checks around, the more weigh stations they went through, the more opportunities you had to grab money from the bank without their knowledge or at least without their acquiescence, and earn money on it.

Am I wrong?

Mr. SULLIVAN. Yes, sir.

Mr. MAZZOLI. I am wrong. Tell me how I am wrong.

Mr. SULLIVAN. The reason for that is that the reason the branches were drawn down by the region was to expedite the clearance of that check. If the banking system didn't clear that check the next day, there were available good moneys there.

Mr. MAZZOLI. I am not so sure I agree with that, Mr. Chairman, because would not the quickest way for using the example of Louisville-Chicago-New York, wouldn't it be quicker to have the Chicago office write the check and fly it down on some Eastern flight to Louisville so it got to the bank the same day or first part of the next morning, so when Louisville called, the check would have arrived—wouldn't that be the quickest way?

Mr. SULLIVAN. Many banks do that.

Mr. MAZZOLI. I yield back to my chairman, but it seems to me if Hutton were serious about expediting the handling of this so the $50,000 was earning its legitimate funds but once, then it would have itself, I do not mean the bank, but it would have somehow flown the check written on the little bank, somehow gotten that check to Louisville on the same day or at the beginning of business the next morning. So it just seems to me the more weigh stations the more likely the delay.

Mr. HUGHES. Let me just say I just find that almost unbelievable. In order to carry out this particular transaction, the people in the New Orleans branch would have to write a check on the Houston bank and make that deposit.

Mr. SULLIVAN. Correct.

Mr. HUGHES. Then the Dallas branch would have to write a check on the New Orleans bank.

Mr. SULLIVAN. That is correct.

Mr. HUGHES. And then the Houston region would draw a check presumably for the same amount on the Dallas bank.

Mr. SULLIVAN. That is correct.

Mr. HUGHES. And then New York would write a check on the Houston regional account.

Mr. **Sullivan**. That is correct.

Mr. **Hughes**. And you are suggesting that that is faster than just Houston initially drawing a check?

Mr. **Sullivan**. Mr. Chairman, in the Charlotte region, which included our Florida group, the Charlotte regional bank could not draw down a branch in Florida without getting 2-day availability. I brought that problem——

Mr. **Hughes**. That was not my question. My question is, are you suggesting you have to run it through five banks to, in fact, expedite the payment of the check?

Mr. **Sullivan**. That was the system that South Central had.

Mr. **Hughes**. I know it was the system and it was the system that you put in effect. You know, it is just totally inconsistent with your testimony that this type of activity was not going on under your leadership. In fact, that just defies logic, to suggest that you have to go that circuitous route in order to expedite payment of a check.

Let me move to something else because my time is about up again.

I want to take you back to the memo of March 7, 1980, where you were present along with Joel Miller, Louis Lynn, Pat Gallagher, John Tesoro, Tom Rae and others, Michael Castellano, et cetera. I wonder if you can tell me what this means in the second paragraph, and I show you the memo. The memo is a matter of public record. It says:

> In addition, Hutton has put up as collateral available customer securities and DTC to "cover" the various banks' uncollected funds.

Do I understand that what that is saying is that E.F. Hutton uses customers' collaterals, customers' funds as collateral to cover uncollected funds in various banks?

Mr. **Sullivan**. No, Mr. Chairman.

Mr. **Hughes**. What does it mean?

Mr. **Sullivan**. I would like to explain it to you. This particular paragraph that you are referring to—and I mentioned earlier—we had a CEA offset arrangement with various banks. In addition to the drawdown system, that was for the branches, which was drawn down to New York, had the effect of paying off a customer bank loan. Customers buy securities on the margin. They pay part of that price and the money, the balance is advanced to them and we are allowed to pledge their collateral to borrow money.

Mr. **Hughes**. So E.F. Hutton has equity in those particular securities?

Mr. **Sullivan**. No; the bank has a position in those securities because we pledge those securities to the bank. But this specific paragraph is talking about, in my commodity offset arrangement, which is where we had segregated commodity funds placed with the bank, that the bank allowed us to be zero book and unavailable the same dollars. However, they requested that we have customer collateral up to support the negative position of availability. That is what that refers to.

Mr. **Hughes**. But it is the use of customers' funds as collateral on uncollected funds. It does mean what it says.

Mr. SULLIVAN. No, sir, it is not talking about customer moneys at all. It is talking about the collateral that we could pledge to a bank and borrow money to support the debit balance in the customer's account. So the collateral that was pledged was the collateral that was allowed to be pledged.

Mr. HUGHES. Moving to the last paragraph, "The client maintains that the key"—who are they referring to as client? Are you being referred to as the client, representative of the client? "* * * Maintains that the key to engaging in such transactions," referring to the drawdowns of uncollected funds, "is that Hutton has the means to make ultimate payment."

You alluded to that. The system was OK. It was legal. Your attorneys told you it was legal, because Hutton, for one thing, had the means to pay.

Hutton's balance sheet showed that at one point there was about $207 million in checks payable at the end of the fiscal year.

Are you suggesting that Hutton at that given time had the liquidity to cover $207 million?

Mr. SULLIVAN. $207 million, Mr. Chairman, is that——

Mr. HUGHES. The balance sheet, yes, that was the checks payable at a given time, $207 million.

Mr. SULLIVAN. Hutton had the ability to borrow money using customer collateral. If you had $200 million in drafts payable or customer payables, Hutton had more than $200 million available to it.

Mr. HUGHES. Does that sound logical to you? Did that sound logical, that you could write bad checks—and that is what we call them when we talk about uncollected funds—as long as you had the wherewithal to cover it with other assets, it is okay?

Mr. SULLIVAN. Mr. Chairman——

Mr. HUGHES. Did that bother you at all?

Mr. SULLIVAN. Mr. Chairman, we never wrote a bad check. We had in addition to drawdown that recaptured the value of the money, which was Hutton's moneys, the——

Mr. HUGHES. I call a bad check a check that you draw when you do not have sufficient funds. I call that a bad check.

Mr. SULLIVAN. Zero balance checking, which the banks tell us—we write checks all the time and there is no money in the bank.

Mr. HUGHES. Obviously something went wrong somewhere along the line because E.F. Hutton pleaded guilty to 2,000 counts of wire and mail fraud, and a lot of banks were not privy to it. So——

Mr. SULLIVAN. That was after I left, Mr. Chairman.

Mr. HUGHES. But it seems to me many of the practices that were put in by yourself were practices without controls and ended in this abuse. You pride yourself in being sensitive to the needs of banks. How many banks did you talk to and tell them that this was a scheme that you were going to put in place?

Mr. SULLIVAN. By asking for a——

Mr. HUGHES. Answer my question. How many banks did you talk to to tell them this was a scheme you were going to put in place?

Mr. SULLIVAN. The addition to drawdown? This commodity offset system——

Mr. HUGHES. In response to the colloquy with my colleague from Kentucky and other colloquy here today, you put in place a system that would, in fact, say if a bank had $50,000 of our money we are going to unilaterally take advantage of that $50,000 and do to the banks what you felt they were doing to you. You created—if it were $50,000—a $50,000 credit through the use of a check that E.F. Hutton used without the knowledge of the bank.

Mr. SULLIVAN. The $50,000 would never exist if the bank's check processing system processed the checks every day. There would have been no addition to drawdown.

Mr. HUGHES. Did the banks understand what you were doing?

Mr. SULLIVAN. Through the account analysis, yes, Mr. Chairman.

Mr. HUGHES. You are saying through the account analysis.

Mr. SULLIVAN. Yes, sir.

Mr. HUGHES. You are saying the banks were aware of what you were doing?

Mr. SULLIVAN. The banks were aware that I asked for the availability——

Mr. HUGHES. Did you ever go to the banks and tell them you were going to implement this system?

Mr. SULLIVAN. No.

Mr. HUGHES. How can you say that you were fair to the banks? You suggest to us that—you are sensitive to the banks, you want to be fair to the banks. Would not it be logical for you to go to the banks, the people you are dealing with, and tell them we think this is a fair system and what do you think? Do you think you can go along with it?

Mr. SULLIVAN. Mr. Chairman——

Mr. HUGHES. Would not that be the appropriate, the fair arrangement with banks?

Mr. SULLIVAN. The account analysis that the account officer has to send us brings to the attention of him the profitability in the corporate account. What is fair is that the banks in the same term should write to their clients and tell them how much money they have available and that they can earn money on that.

Mr. HUGHES. Well, something went wrong, did it not, Mr. Sullivan, after you left?

Mr. SULLIVAN. That is correct.

Mr. HUGHES. Yes. I wonder if you can tell us what went wrong. It was your system. What went wrong and if you had been there, how could you have picked it up?

Mr. SULLIVAN. First of all, I was not there and Mr. McCollum asked me that and I talked about chaining.

Mr. HUGHES. But it was your system that was developed which went through some transitions and it ended up in conviction of E.F. Hutton for wire and mail fraud. What went wrong?

Mr. SULLIVAN. If they followed that work sheet nothing could have gone wrong. If they followed the work sheet and got DCAN analysis, DCAN analysis money management would have been aware of what was going on in the banks and by following the work sheet the branches would not have taken more money from the bank than the bank had.

Mr. HUGHES. Your testimony is if, in fact, they had stayed with the procedure, the work sheet which looked at the account, how much was deposited, anticipated how much cash or checks on that particular bank was involved so that you would have immediate availability, there would not have been a problem? Is that your testimony?

Mr. **SULLIVAN**. Just one word is wrong. You said anticipated cash. It was actual cash. We never anticipated cash.

Mr. **SMITH**. Would the gentleman yield?

Mr. **HUGHES**. The gentleman from Florida.

Mr. **SMITH**. Let me give you an example and see if I am correct. On Monday you have zero book balance. A check is deposited for $50,000. Tuesday you call the bank. They have $50,000 on account. On Monday the $50,000 was moved to the region, on Monday.

Mr. **SULLIVAN**. Yes, sir.

Mr. **SMITH**. Tuesday they have it on account because somehow the check did not clear through the Fed. You draw down another $50,000 on Tuesday.

Mr. **SULLIVAN**. No, sir.

Mr. **SMITH**. You do not?

Mr. **SULLIVAN**. No, sir, because in the account analysis—in the work sheet I presented everybody, you will notice on Tuesday morning you must take away the previous day's drawdown. The assumption is that check will be presented today for payment, so Wednesday is the first time that that works out.

Mr. **SMITH**. Wednesday the check does not clear?

Mr. **SULLIVAN**. That is correct.

Mr. **SMITH**. You draw down another $50,000?

Mr. **SULLIVAN**. We—after you work out the work sheet, we would take back the value of the $50,000 and add it to our drawdown.

Mr. **SMITH**. What do you mean, the value of the 50,000?

Mr. **SULLIVAN**. The bank had $50,000 of Hutton moneys on Tuesday. We recaptured the value of that $50,000 by adding to our drawdown.

Mr. **SMITH**. In other words, you calculated the interest?

Mr. **SULLIVAN**. The value, yes, sir. The dollar value, not the interest, but the $50,000 is what we calculated.

Mr. **SMITH**. So it is $50,000.

Mr. **SULLIVAN**. Not in interest, but it is the value of $50,000 that we add to the drawdown.

Mr. **SMITH**. Remember, I am isolating this case, so there are no additional deposits by this branch. Monday the deposit is $50,000; there is a drawdown Monday night to the region of $50,000; on Tuesday your work sheet provides you with no additional drawdown even though the money is in there because you deduct Monday night's drawdown on the Tuesday work sheet.

Mr. **SULLIVAN**. That is correct.

Mr. **SMITH**. Wednesday there is still no clearance, no additions. You draw down another $50,000.

Mr. **SULLIVAN**. Yes.

Mr. **SMITH**. That is transferred to the region. The region now has $100,000, correct?

Mr. **SULLIVAN**. That is correct.

Mr. **SMITH**. The region has since Monday night and then again on Wednesday the availability of $100,000 and its value, correct?

Mr. **SULLIVAN**. It would only have $50,000 on Tuesday.

Mr. **SMITH**. Because it issued a check.

Mr. **SULLIVAN**. Right.

Mr. **Smith**. Right?

Mr. **Sullivan**. New York would have drawn down the region on Monday. So the region would not have $50,000 on Tuesday; New York ultimately would have the money.

Mr. **Smith**. The end of the banking chain would have the money.

Mr. **Sullivan**. Correct.

Mr. **Smith**. Now, on Wednesday that would be drawn down from the local bank to the region and the region would be drawn down by the bank, the ultimate end, New York, for instance, so on Wednesday it would have $100,000. New York would have $100,000.

Mr. **Sullivan**. That is correct.

Mr. **Smith**. You have created out of a $50,000 check $100,000 worth of value of money, correct? You made two $50,000 deposits into an ultimate depository, thereby accruing $100,000 on paper of value for which you could draw on, correct?

Mr. **Sullivan**. If nothing else happens on Wednesday?

Mr. **Smith**. Yes.

Mr. **Sullivan**. We would have had to put a BRC in——

Mr. **Smith**. I am getting to that. You would then have to route back to the local branch a check for $50,000.

Mr. **Sullivan**. That is correct.

Mr. **Smith**. To cover the second $50,000 drawdown?

Mr. **Sullivan**. That is correct.

Mr. **Smith**. Because there was only one $50,000 deposit you made originally, but two withdrawals.

Mr. **Sullivan**. And the bank had the value of $100,000. That is correct.

Mr. **Smith**. The bank had the value of the $100,000 except it never got the cash, did it?

Mr. **Sullivan**. Sure it did. If the check did not hit the second day, they had the value. So they had the value for 2 days. They had it for Tuesday and they had it for Wednesday. It is a cumulative figure.

Mr. **Smith**. So did you, correct? If the bank had it, E.F. Hutton had it?

Mr. **Sullivan**. E.F. Hutton got it afterward. First the bank had to have it; then we took it back.

Mr. **Smith**. On Tuesday E.F. Hutton had $50,000 value.

Mr. **Sullivan**. Correct.

Mr. **Smith**. On Wednesday E.F. Hutton had $100,000 value. When would E.F. Hutton have issued the $50,000 check to cover the second drawdown? On Wednesday?

Mr. **Sullivan**. On Wednesday.

Mr. **Smith**. Therefore, the bank had it on Wednesday and you had it on Wednesday because you would not draw your check until the end of the day, correct?

Mr. **Sullivan**. The bank had the money for Tuesday and Wednesday, for 2 days, the $50,000 on Tuesday——

Mr. **Smith**. So if you subscribe to your argument that the bank had the value of the money even though the check had not cleared, but you also had the value of the money, did not E.F. Hutton have the value of that $100,000?

Mr. **Sullivan**. In total E.F. Hutton had the value of that $100,000, yes.

Mr. **Smith**. That means that a $50,000 original deposit made two different companies have the value of $200,000 between them for 2 days; is that correct?

Mr. **Sullivan**. The bank would have an accumulative value of $100,000, but at least they had $50,000.

Mr. **Smith**. And you had the value of $100,000 by the end of Wednesday?

Mr. **Sullivan**. That is correct.

Mr. **Smith**. Until you issued the $50,000 check back.

Mr. **Sullivan**. That would be correct.

Mr. **Smith**. So two companies had a total accumulated value of $100,000 each on one $50,000 deposit made on Monday by E.F. Hutton into a bank; is that correct?

Mr. **Sullivan**. The bank had $50,000 for 2 days, and E.F. Hutton recaptured the $50,000 for 2 days. It is not the same days.

Mr. **Smith**. Oh, I understand, you know. This is one of the problems too. You are looking at it on the basis of the paper transaction but calculating the value of the money based on instantaneous availability?

Mr. **Sullivan**. No, sir. No, sir.

Mr. **Smith**. If the money is deposited on Monday at 4 o'clock in the branch bank and you pull it out at 5 o'clock in the regional bank, there is no money. It is paper value.

Mr. **Sullivan**. That is right.

Mr. **Smith**. But you are claiming the value instantaneously even though there is no money.

Mr. **Sullivan**. The value of the money is not Tuesday. The vehicle is the check. Is that what you refer to?

Mr. **Smith**. That is correct.

Mr. **Sullivan**. The drawdown——

Mr. **Smith**. You used the $50,000 to route through to your ultimate bank in New York, so you have pulled out the same value that the bank has—it only got a paper check—the same value E.F. Hutton has because it is almost simultaneous; 4 o'clock into the local bank on Monday, a customer's check; 5 o'clock the region draws down the $50,000. Neither one has been converted into cash.

Mr. **Sullivan**. That is right.

Mr. **Smith**. But now there are two $50,000 paper values out of one $50,000 check almost simultaneously. On Tuesday the bank has not had the check cleared. You now do not route back a check because you do not have to because there is no demand for covering that first check because the bank has not had the other check yet; therefore, you now duplicate on Wednesday morning another $50,000 drawdown——

Mr. **Sullivan**. Only if on Tuesday the bank did have it because you said the bank did not have it on Tuesday though. The bank has the money.

Mr. **Smith**. Tuesday morning. I am just trying to make the point, Mr. Chairman, that you have created a fund of $100,000, you claim in each place, the value of the money in Hutton, which you have taken two $50,000 draws, the value of the bank which had the $100,000 according to you and that is why you drawdown out of one $50,000 deposit and, as the chairman said, that defies every piece of logic that anybody would ever imagine.

Mr. **Hughes**. I just want to say, by way of followup, I gather the rationale for that was that the bank had the moneys available for that first day.

Mr. **Sullivan**. No, the second day, Mr. Chairman. On Monday we put in the check——

Mr. **Hughes**. E.F. Hutton had it the second day because you draw down the second day.

Mr. **Sullivan**. We draw down on Monday which would be presented to the bank on Tuesday.

Mr. **Hughes**. So you would have it available the second day.

Mr. **Sullivan**. That is correct.

Mr. **Hughes**. So you were at that point at equipoise with the bank.

Mr. **Sullivan**. If the check was presented to the bank on Tuesday, it was all equal.

Mr. **Hughes**. Well, I think the procedures were geared so you would have the funds available on the second day.

Mr. **Sullivan**. The banks agreed to give us next-day availability.

Mr. **Hughes**. That is correct. You had availability.

Mr. **Sullivan**. Yes.

Mr. **Hughes**. What I have concerns with is that availability and the drawdown becomes interchangeable and there are two different operations there.

You were getting almost immediate availability and yet you were creating on the third day—and if, in fact, you called the bank on Wednesday and found you had $50,000 on deposit in the bank in the third day, you draw another check so you would have $50,000 available the third day, and if, in fact, the check had not cleared by Thursday, you draw down another check on Thursday and have another $50,000. So now you have $200,000 for the $50,000 deposit. Isn't that correct?

Mr. **Sullivan**. No, Mr. Chairman. The check that we draw down on Monday, if it were presented to the bank on Tuesday, we would be even.

Mr. **Hughes**. What if it is not presented until Thursday?

Mr. **Sullivan**. On Wednesday, for the first time we would know the check didn't get presented for payment on Tuesday and take that $50,000 and add it to our drawdown. At that point in time, we have now recaptured the value of the $50,000 that was left with the bank unintentionally.

Mr. **Hughes**. You would not draw another $50,000 on Wednesday? If the bank ledger showed they had $50,000 credited to your account, you are trying to accomplish zero balance, you would not draw down on Wednesday?

Mr. **Mazzoli**. Mr. Chairman, may I add, is it not the case, Mr. Sullivan, if there was a slowdown, a strike, the Postal Service didn't work as well as it should, and the check took a longer time than usual to clear, every day after Wednesday you would take another $50,000 value?

Mr. **Sullivan**. If it did not clear, we would take it out.

Mr. **Mazzoli**. That is every day.

So what the chairman says, if it went to next Tuesday, from Tuesday to Tuesday, every day after Wednesday you would take another $50,000 value. That check kites.

Mr. **Sullivan**. No, it just recaptures the value.

Mr. **Hughes**. Oh, we understand. You did a lot of recapturing of value, I can tell you.

Mr. **Mazzoli**. Can I ask——

Mr. **Hughes**. The gentleman from Kentucky.

Mr. **Mazzoli**. It seems to me, and I appreciate what Mr. Sullivan is saying, when you came in, your predecessors were using this future availability, which you thought was wrong because they were anticipating moneys and that was wrong. It seems to me what you have done and set up is the same thing by using a lot of intermediary weigh-stops for these checks.

You have created the same kind of anticipation that your predecessors did using some sort of judgment of what moneys would come into them. It seems to me you have done the same thing by having a system that the chairman has pointed out is so circuitous that it defies logic.

Mr. **Sullivan**. The system was the branches to the regions. There was no anticipation and no slowing down.

Mr. **Hughes**. I have just one final question. Getting back to the Andersen document, the memo of March 7, you make the statement during the course of that meeting that Hutton has always been "above board in its dealings with the banks. The banks were fully aware of the nature of these transactions."

That is not accurate, is it? The banks were not aware of these transactions?

Mr. **Sullivan**. Yes, they were, Mr. Chairman, because——

Mr. **Hughes**. Back in 1960 to 1970 many of the banks didn't have the ability to analyze the account, Mr. Sullivan.

Mr. **Sullivan**. 1960, 1970?

Mr. **Hughes**. We are talking about the time frame, latter part of 1970, and many banks didn't have the ability to analyze.

Your testimony, if I understand it, is that the banks had to know what was going on because of their analysis of the account.

Mr. **Sullivan**. This particular paragraph that is in this memorandum is specifically talking about the CEA offset.

Mr. **Hughes**. Talking about different accounts; you are not talking about the branch accounts?

Mr. **Sullivan**. No, sir.

Mr. **Hughes**. Let me ask you about the branch accounts. Isn't that also pertinent? Because you set up a practice whereby you were drawing down from the banks, and I think you conceded you did not have any conversations with the banks and tell them the system you were putting in place.

Mr. **Sullivan**. Right.

Mr. **Hughes**. Do you feel that was fair to those banks to put in place this procedure and not share what you were doing with the banks?

Mr. **Sullivan**. I believe I asked for the account analysis; they were aware of what was going on and the banks did have account analyses on the accounts we were using. The banks in the field were able to provide that.

Mr. **Hughes**. Why, Mr. Sullivan, were the banks not aware, that we have talked to, were not aware of these practices? Should not it have been contractual between E.F. Hutton and the banks?

Wasn't there all kinds of red flags? Certainly you must have envisioned potential abuses in the system?

Mr. SULLIVAN. I believe by having an account analysis on a monthly basis, if there were any abuses they would show up and I would correct those.

I also had an ongoing dialog, as you have seen, with many banks throughout the country about our accounts. I think I was fair. I think I presented to the banks our program.

Mr. HUGHES. What we ended up with, and this is my final question in this area, is a system you implemented, which then went to an anticipated drawdown, aggressive overdrafting, deposits, $70,000, and drawdown $9 million or $7 million, where there was no relationship between the deposits and amount of drawdown, which is far from what you have set up, correct?

Mr. SULLIVAN. That is correct, Mr. Chairman.

Mr. HUGHES. If you were the money mobilizer, how would you have picked that up?

Mr. SULLIVAN. First of all, you have to fund the day's operations in the cash desk area and you have to fund them in what we call Federal funds, which is cash. If there were large amounts of cash being drawn down somewhere in the system, you would have to fund those cash dollars so you would have had an awareness that——

Mr. HUGHES. Could you have the type of chaining—you are familiar with the company—could you have the type of chaining, the effort to slow down presentation for payment, and the aggressive drawdowns, a drawdown of $7 million for $70,000 in deposits, without people at many areas of the company not being aware of it? Could you have that kind of a scheme and not have an awareness of what was going on within the company?

Mr. SULLIVAN. No, sir.

Mr. HUGHES. Can you tell us how people at headquarters could have been unaware of that type of a scheme when you have the kind of checks payable, $207 million, the kind of aggressive overdrafting that you have read about and come to understand occurred? Could you have that occur without people in the company hierarchy knowing about what was going on?

Mr. SULLIVAN. First of all, Mr. Chairman, in order to do the chaining, the basic concept had to be changed, and that was, instead of the region holding the checkbooks, the branches would have had to hold checkbooks, which would be a deviation from the normal system, which is the branches and regions, so physical movement. Checkbooks from an area at least would make the region aware of a change at that level.

Funding the BRC—as has become the branch reimbursement check—would be known to money management because we had to fund, or money management had to fund these large amounts of monies.

Now, when you fund the amount of money, it is through a bank loan. So the loan interest would just be processed by the accounting department as loan interest.

The negative balances, though, would be reported on what we had back when I was with E.F. Hutton called a bank listing, and it showed the branches and region and their account numbers.

If you did my drawdown sheet, the figures would change because the premise was that the checks would clear every day, and many times the checks do clear. I know that many committee members don't believe that, but checks do clear in the normal process.

You would have seen, based on what comments you have made and what I read in the paper, a consecutive figure every day, and every day that couldn't be on a worksheet like that because it just wouldn't work. So you had to be aware through the bank listing that something was going awry and that branches were having large amounts of negative balances that may have no relationship to their business they are doing in the branch.

So the bank listing which we received every day would have shown the repetitive amount.

Mr. HUGHES. How could the chief financial officer of the company not be aware of the practices when you generated so much interest profit and required so many decisions insofar as use of the zero balance account to cover large amounts?

Mr. SULLIVAN. I think——

Mr. HUGHES. With problems, from time to time, that banks had of letting the company know they are upset because they have been overdrawn by millions of dollars.

How could that occur without the chief financial officer of the company not knowing?

Mr. SULLIVAN. I would like to say this for the record, that while I was there, we didn't have such a relationship that we had complaints. In the normal course of business, while I was at E.F. Hutton, on Wednesday, many of our bankers come in to say hello. They would always like to meet Mr. Tom Lynch, who was the financial officer of the firm.

If something were to go wrong with the banking relationship, and Hutton had prided itself and I prided ourselves on good bank relationships, if something went wrong with those relationships, they would have spoken to the money manager.

If it was not resolved and we have banking relationships that are an ongoing relationship, if the problem wasn't resolved, the bank would normally have asked to speak to Tom Lynch, the chief financial officer, if there were problems in the bank relationship.

Mr. HUGHES. One of the things that evolved, obviously, was many, many branches involved in aggressive overdrafting. In your judgment, from your knowledge of the structure and the system that you put in place, could you have a scheme such as the one that I have described without there being a policy putting that in place in the various regions?

Mr. SULLIVAN. In my era, voluntary. If it was put in mandatory——

Mr. HUGHES. No—my question is, could you have that elaborate scheme without it being a policy from headquarters?

Mr. SULLIVAN. The region had autonomy——

Mr. HUGHES. The reason is that we seem to have had spontaneous combustion. The managers thought they could maximize interest profits. They get a bonus for that and all of a sudden, throughout the company, why, these practices just appeared from nowhere. Do you find that logical?

Mr. SULLIVAN. No, sir.

Mr. **Hughes**. The gentleman from Florida.

Mr. **McCollum**. I don't have any more questions, Mr. Chairman. I think this has been very thoroughly explored.

Mr. **Hughes**. The gentleman from Florida.

Mr. **Smith**. I just have about two questions.

That used to happen in Shakespeare, deus ex machina, or somebody used to sweep down from heaven. That seems to have happened here.

In testimony previously by the chairman of the board of E.F. Hutton, we understood there was no policy put in place to do this. We were told the regions were extremely competitive and they looked for ways to make more money, branch managers and the like.

Can you tell me if, during the term you spent with E.F. Hutton, 6 years approximately, you would have ever seen a program evolve in all the regions simultaneously, practically the same in each region, with everybody reporting up to the money manager on the top level, the checkbooks having been moved back from the region back to the branches, as you just testified, and all that happened without any policy of the company?

If they were so competitive, if one region got a good thing, would they have told the other regions about this ability to generate these profits?

Mr. **Sullivan**. First of all, if somebody wanted to have such a dynamic system—I know that many of you think my system was dynamic——

Mr. **Smith**. Oh, that is an understatement.

Mr. **Sullivan**. I would want to know why everybody wanted to do it. My system was voluntary because it required them to do work.

The regions had meetings among themselves; the regional vice presidents had meetings, I assume, on a yearly basis. To make such a major move would even astound me because of the way Hutton operated.

Each region had its own autonomy. If an item was a good item, it would still take a lot of time to implement that.

So, to answer your question directly, if everybody did it the same time, I would be amazed.

Mr. **Smith**. You would be amazed and you would have to believe, frankly, that it could not have evolved spontaneously?

Mr. **Sullivan**. Yes, sir.

Mr. **Smith**. Second question: In the memo which is now in the record, interoffice communication, when there was a meeting with Arthur Andersen and E.F. Hutton, there is the statement that the CEA cannot be used by the bank to cover shortages in Hutton's general account, are treated as offsets by the bank under a global approach, which allows Hutton to overdraw its balances.

Then it goes on—I think this is referenced to you—"The client maintains"—I believe you are the one that is doing the talking at this particular meeting—"that the key to engaging in such transactions is that Hutton has the means to make ultimate payment. In other words, in the normal course of business the settlement of transactions will result in actual cash balances," and, "as a result, the balances per bank are rarely, if ever, overdrawn."

When they say the means to make payment——

Mr. SULLIVAN. Mr. Chairman, Mr. Congressman, that was Mr. Rae that stated that.

Mr. SMITH. OK.

You don't, however, disagree with that statement, do you?

Mr. SULLIVAN. We had collateral and the ability to borrow money, yes, sir.

Mr. SMITH. You had the means to make ultimate payment?

Mr. SULLIVAN. That is correct.

Mr. SMITH. This was a global use of your money, that the structure of the company, the value of the company ultimately allowed for this to go on, because at no time was there a threat to either the banks getting any payment or the company having liquidity problems?

Mr. SULLIVAN. There is——

Mr. SMITH. The means to make payment.

Mr. SULLIVAN. The reason you can recapture the value of the money, the value to Hutton was to reduce customer bank loans. We always had customer collateral, had nothing to do with E.F. Hutton or its capital.

We are referring to reducing the bank loan by taking the value of this money. Customer collateral was still there and still existed, and we could borrow the money. That is what I mean by the means to meet it—nothing to do with the firm's liquidity.

Mr. SMITH. Final question: You described how you would drawdown on Monday night of an item deposit and if it didn't clear Tuesday, you would drawdown Wednesday, et cetera. This is going on all over the country under your system, or assuming no hype, no negative use of this sytem.

Let us assume on Friday, after one week that this had happened under this means to make ultimate payment test, you had all these checks outstanding and you had to write checks to cover all these additional drawdowns that you made, because you will admit if you drew down $100,000 on a $50,000 check, eventually you would have to channel an additional $50,000 back to the bank; is that correct?

Mr. SULLIVAN. That is correct.

Mr. SMITH. Let's assume on Friday you were served with an injunction by the banking regulators or whatever, freezing every piece of business that E.F. Hutton could do, and they said, "Now, settle up. You can't take in any money; you can't do anything. Settle up."

Mr. SULLIVAN. It would make a lot of my banks happy because they take that customer collateral and bring it to them; they would lend me the money to make the payment that you asked about.

Mr. SMITH. So that means you have the ability to borrow money?

Mr. SULLIVAN. With customer collateral.

Mr. SMITH. Let me finish the premise, because that is very interesting.

You have the use of all that money during the week, and at the end of the week, if you were forced to settle and E.F. Hutton could do nothing else, you had the means, you relied on the good will and liquidity of the organization, which means if Mr. Mazzoli wanted to deposit $1,000 in his account on Monday and if Tuesday he did it, wrote one on Tuesday, and one on Wednesday and one on Thursday, which you admit would be done if it didn't clear, the first $1,000, that Friday, if he was served with the same injunction and said, "Settle up," he would say, "I am going to mortgage my house, my collateral, do whatever else, and I can make payment to you," and the banks would be very happy, although Mazzoli for that 4 days had hyped that $1,000 check into four other $1,000 checks and basically borrowed money without collateral. But when forced to fess up, to pay up, says, "Oh, I have the means and here it is."

Is that what you consider to be what E.F. Hutton did, but that Mr. Mazzoli, under every law that I know of, would be prosecuted for?

Mr. SULLIVAN. First of all, if Mr. Mazzoli—there are two differences here.

To take out a check and tomorrow only put in a check is incorrect, because it is the cash value of that money.

Mr. SMITH. What is the difference between Mazzoli depositing a $1,000 check made out to him from his grandmother and then drawing the same check on Monday, because it is there in the bank, and sending it to a bank for payment on one of his loans, and then he calls the bank on Tuesday and he says to them, "Do I have the $1,000 on deposit?" "Yes," because the check didn't come back. He knows that, but the bank doesn't know that, but he writes me a $1,000 check on Wednesday, when he calls the bank and they say, "Yes, the $1,000 is still there."

Mr. SULLIVAN. There is an item that you—I know you know this answer, but I will have to say it—there is an item called collectibility. The collectibility is the risk factor that a check will bounce.

Unlike a customer, a corporation is given a different collectibility figure than the customer. So when you use the purist example, you are correct, but in reality, banks hold back the collectibility item and it is seven days.

Mr. SMITH. Isn't that interesting.

Mr. HUGHES. I would say to the gentleman, we have four other witnesses.

Mr. SMITH. I understand.

Thank you, Mr. Chairman.

Mr. HUGHES. It is fascinating, but I think we have exhausted that subject. We have been around it about five times now.

Do any other members have questions? We do have four other witnesses, as I say.

If not, thank you, Mr. Sullivan. We appreciate your testimony.

Mr. HUGHES. Our next witness is Mr. John Holland. He is currently an E.F. Hutton branch office manager. Joined E.F. Hutton in July 1980 in the Pennsylvania office. In August 1980, he became an account executive in charge of the Wilkes-Barre office in the Atlantic region. In early 1981 he became Wilkes-Barre branch manager.

In July 1984 became the branch manager in another branch in another region.

Mr. Holland, on behalf of the Subcommittee on Crime, we welcome you this morning. Let the record indicate that pursuant to clause 2 of rule 11 of the Rules of the House of Representatives, copies of the rules of the committee of clause 2, rule 11 of the Rules of the House have been made available to the witness and are available at the witness table.

Mr. Holland, you have a right to counsel to assist in the course of these proceedings. Are you accompanied by counsel and if so, will you identify him.

Mr. Holland. Yes. Mr. Jack Tigue.

Mr. Hughes. Welcome. Would you give your full name.

Mr. Tigue. I am John J. Tigue, Jr.

Mr. Hughes. I will place you under oath, Mr. Holland.

Raise your right hand.

[Witness sworn.]

Mr. Hughes. Please be seated.

Mr. Holland, you may proceed as you see fit. Basically what I would like you to do is just quickly if you can, tell us a little about Wilkes-Barre, the region it is in, and your responsibilities there.

TESTIMONY OF JOHN HOLLAND, BRANCH MANAGER, BOULDER, CO, E.F. HUTTON

Mr. Holland. Yes, Mr. Chairman, as you pointed out, I joined E.F. Hutton as an account executive in Wilkes-Barre in June or July 1980 and opened an office within what was known as the Atlantic region in August 1980 with myself, two other account executives and a trainee.

I was a satellite of the Wyomissing office which is in Pennsylvania, also, and I was the AE in charge until I passed certain licensing and regulatory exams and continued to be a satellite of Wyomissing until January 1983, when I was a full branch.

Mr. Hughes. But you were in the Wilkes-Barre area from 1980 to 1982.

Mr. Holland. That is correct, from August 1980 until July of 1984 I was the manager of that.

Mr. Hughes. As branch manager, did you receive 10 percent of the branch's interest profits?

Mr. Holland. When I started off as the opening of the office in August 1980, no, that is not correct. I did not receive 10 percent of the profits until I went to a full branch ranking, which was in January 1983.

Mr. Hughes. Then it was 10 percent, was it?

Mr. Holland. Ten percent of the net office profit, that is correct.

Mr. Hughes. Was that how you were remunerated basically, was by the profits, or did you have a draw in addition?

Mr. Holland. Unlike many of the other counterparts in the Hutton system, I was what was known as a producing manager, and I would venture to say that approximately 95 to 98 percent of my income came from my retail production as an account executive dealing with my own clients.

Mr. Hughes. Who at either the regional or corporate level instructed you and your employees to draw down?

Mr. Holland. Initially when the office was opened in August 1980 and we had operational staff, which consisted of the position that we will be interested in today of the office cashier, she would go to New York for training seminars. I am not absolutely positive who ran those seminars. They ran from 2 to 3 days. The one name

I do know, the gentleman that was at those seminars, was a gentleman named Mr. van Hengel.

I myself, in terms of as part of an ongoing educational process with all phases of branch management, attended various training seminars in New York.

Mr. HUGHES. Who were they run by?

Mr. HOLLAND. They were run by various—depending on—it covered everything from compliance and supervision of account executives. There was a full range of individuals who would come in and speak to us depending on their various degrees of expertise in a particular area.

Mr. HUGHES. Did you receive any other instructions about the cash management practices?

Mr. HOLLAND. Yes, I did.

Mr. HUGHES. And from whom?

Mr. HOLLAND. There was a section of the seminar where one of the officers in my region, a gentleman named Mr. Alan Rhein, came in and spoke to us about drawdown procedures.

Mr. HUGHES. Did you have a cashier or cashiers actually trained in drawdown working under you?

Mr. HOLLAND. Yes, I did.

Mr. HUGHES. And how was it determined, starting in 1980, as to how much you would draw down on a daily basis? Why don't you walk me through in your own words the procedure that was used, how that changed if it changed over the years that you were there from 1980 to 1982, 1983; how it was implemented, and who made the changes? Can you walk us through that in your own words?

Mr. HOLLAND. OK.

Initially when my office was opened, because it was a very small office, I was drawn down by an office in Wyomissing, PA, which was my parent office. This practice continued—as our office grew in amount of cash receipts that came in increased, at some point, and I really don't remember, Mr. Chairman, when this happened, the procedure changed.

The drawdown sheets to the best of my recollection during the period in question, No. 1, they were very, very complicated; two, they changed as many as three times during the period that we are talking about; and you know, I know I didn't understand them, I don't know how many of the cashiers particularly understood them.

Initially it was my cashier dealing with New York, either what we call the cash management desk or the regional operations desk, and/or the Wyomissing office.

Mr. HUGHES. Was your cashier advised as to how much to draw down or how was it determined how much to draw down on a given day?

Mr. HOLLAND. Initially I believe New York handled everything.

Mr. HUGHES. Who in New York would give you or your office instructions on how much to draw down? Walk me through the procedure. You would have to call the bank I presume to find out what your balance was?

Mr. HOLLAND. My cashier would call the bank in the morning and they would give her a figure of what was in our account. She had a legal-size sheet of paper that she would fill in numbers from what was in our bank, what our deposits were, what the opening was, what they called opening balances, and anticipated—there was a very, very complicated sheet.

As I said before, I don't understand it now, I didn't understand it then. I believe, and I am not positive but I believe, the gentleman that initially worked with my cashier was Mr. van Hengel, regional cashier in New York.

Mr. **Hughes**. Regional cashier at headquarters?

Mr. **Holland**. That is correct.

Mr. **Hughes**. OK.

Was he also a vice president of the company? What was his title?

Mr. **Holland**. I have no idea.

Mr. **Hughes**. Was there a time when the cash drawdown changed, the system changed, and if you can, give us an idea of the nature and extent of those changes.

Mr. **Holland**. As I said, during the period in question, two or three different times there were different systems that were introduced. I remember being at one regional meeting. I do not know the gentleman who came in and talked to us about the change in the procedures, and how it was going to be done, but I do recall that during the period we are talking about, that the cash system was changed on at least two or three occasions or the formula was, the sheet used for implementation was changed.

Mr. **Hughes**. What was the transition? You heard the testimony from Mr. Sullivan, the system he put in. You were there when his system was in place.

Mr. **Holland**. No, I was not there at that time.

Mr. **Hughes**. You were not.

Mr. **Holland**. No.

Mr. **Hughes**. The system that Mr. Sullivan put in place, I presume, was in effect while you became branch manager. The system being one of determining how much was deposited and a formula was effected to determine through account analysis as I understand it, of how much was being deposited, cash and checks, and an amount arrived at as to how much was being drawn down.

Was that the first system that you operated under or did you operate at all under that system?

Mr. **Holland**. Initially, sir, again because of the fact that one, the office when I opened it was a very small office and because my compensation was not tied to—my compensation was tied to the management, I had 400 client accounts that I dealt with, and on a transactional basis. I paid little or no attention to the system.

The system was set up in New York. It was worked out of both New York and the Wyomissing office, so that initial phase I am not 100 percent sure.

Mr. **Hughes**. Did there come a time when the company's emphasis was on maximizing interest profits?

Mr. **Holland**. When I attended various meetings in the course of our regional meetings, which were on a semiannual basis, we had numerous breakdowns on every product from tax shelters to bonds to syndicates. One of the areas which we discussed at meetings was the profitability of interest. During the course of my tenure in Wilkes-Barre during this period in time, numerous memos came down from various sources in New York alluding to the fact that interest profitability was—or interest was a very key element to the profitability of our branch offices, and our locations, and it was discussed as in the normal discourse of our business talking about syndicate business, talking about tax shelters, we also talked about interest profitability.

Mr. HUGHES. And were lists comparing the branch interest profits distributed about that time period?

Mr. HOLLAND. That is correct.

Mr. HUGHES. So that there came a time when increased pressure was put on branch managers to try to duplicate what was being done in other branches that were maximizing interest profits?

Mr. HOLLAND. Well, it certainly was—we were all made aware of the fact that some branches were significantly enhancing their profitability through utilization of certain procedures where their net income was increased.

Mr. HUGHES. Were they trying to encourage branches who didn't come up to what they felt was not normal, or what they had hoped to see in the branches that you should bring your own endeavors up to that level? Wasn't that the purpose of circulating these comparisons?

Mr. HOLLAND. I would say yes, sir.

Mr. HUGHES. And did you not feel pressure from the company at the regional meetings and from memos being circulated comparing your branch with other branches that were doing much better than you, weren't they trying to tell you to get with it?

Mr. HOLLAND. They were certainly making us aware of opportunities that there were means available to us to increase it and that we should avail ourselves of it; yes, that is correct.

Mr. HUGHES. Did someone at corporate headquarters monitor these practices?

Mr. HOLLAND. I cannot say every day as a part of our drawdown procedures, which are being discussed here today, wires were sent to individuals both, I believe, at the cash desk in New York and in New York and our regional offices stating exactly what had been done in our branch on that particular day.

Specifically who those wires went to, but it was a part of company policy that these wires were sent, I do not know because I didn't pay attention to that. But I do know those wires were required by the cashier to be sent to certain individuals every day stating what we had done as part of our drawdown.

Mr. HUGHES. Didn't the cashier work for you?

Mr. HOLLAND. Yes.

Mr. HUGHES. And I assume that the ultimate responsibility for the operation of your branch fell to you, not to the cashier.

Mr. HOLLAND. The ultimate—my ultimate responsibility again, putting it in the context of where my branch was as the new operation, my duties were primarily, one, as a sales manager, and the compliance of the other procedures that worked for me for violation of securities laws to make sure that the appropriateness of the types of business that was being done was within the confines of what the securities law says.

The administrative aspects in terms of the day-to-day operations of how much money came in, I received a wire that said customers were overdue, had not paid for a transaction on settlement date, and that was certainly an area of my concern. But the checks that came in to the office, there was a procedure dictated by New York and what cashiers were supposed to do, how it was supposed to be handled, and I did not get involved in that on a day-to-day basis.

Mr. HUGHES. Mr. Holland, I am going to ask you to take a look at a document that we received as a result of a subpoena. It has no first page, so we don't know who wrote it or who received it. I am asking you about it because it refers to branch managers and what they should do in overdrafting of bank accounts.

Without objection I will offer it for the record.

[The document referred to follows:]

I Analyze MHT Monthly Fed Funds Bill

1. Compare MHT monthly statement (EXHIBIT #1) against all daily MHT Fed Fund Analysis sheets (EXHIBIT #2) maintained by Money Management section.

2. The MHT monthly statement shows the net balance of MHT federal funds used by EFH for every day of the month for 6 different accounts (Regular A/C, General A/C, Custodial A/C, Draft A/C, Commodity Exchange. A/C and Dividend A/C). For the Custodial A/C, we also receive a detailed daily statement (EXHIBIT #3).

3. Differences between the MHT monthly statement and the daily MHT Fed Fund Analysis sheets which are in favor of MHT, must be analyzed and adjusted. If the net balance of all accounts for a given day indicates that we are overdrawn, EFH will be charged interest at the brokers call rate or the federal funds rate – whichever is greater.

4. Differences between EFH and MHT for the Custodial A/C are resolved by researching the daily MHT statements against the Custodial A/C check book and also against daily trade detail files maintained by the Broker Clearing Section. Upon determining the cause of any difference, prepare the necessary documentation which will be submitted to MHT for initiating an adjustment.

5. For other than custodial accounts, review any differences with a bank officer (usually by telephone) by checking our logs against the detail files maintained by MHT.

II Branch Overdrafting

1. Overdrafting is accomplished by daily drawing down from a branch or regional checking account in which customer checks are deposited, an amount that will cause the daily average loanable balance to be kept at a minimum (usually below $5,000.) Based on monthly analysis reports from the branch banks, N.Y. will monitor the branch and regional checking accounts and make recommendations to the managers as to the amount they should overdraft. It behooves a manager to overdraft as much as possible since his branch will be credited with inter-branch interest on any credit balance and charged interest on any debit balance (computed daily). The object is to draw down daily a sufficient amount from the average daily loanable balance an amount that would create an overdraft (credit balance) in the EFH books but at the same time because of the float factor, not enough of a draw down to cause an overdraft in the bank's books. This daily overdraft figure for each account can be increased or decreased according to subsequent bank analysis.

2. When a new checking account is opened, have the branch manager request a monthly analysis report (EXHIBIT #4) from the bank.

3. In addition to the above, request that the branch do a 30 day survey on two or three of the checking accounts that are most frequently used to deposit customer checks. The purpose of this is to determine which bank gives us next day available funds (quickest collection) and therefore the most profitable for EFH to do business with. The ideal situation is to deposit customer checks in the same bank in which they are drawn against; thereby giving EFH immediate credit. This will allow EFH to overdraft one day prior to the deposit of a customer check and thus allow us the use of those overdrafted funds at least one day in advance of the actual receipt of those funds.

4. If no monthly analysis is available from a branch bank, N.Y. will do a three month analysis of its own. Sometimes N.Y. will do its own analysis even if a branch does provide one. After obtaining monthly bank statements and paid checks from the Accounting Dept. for prior three months, following is the procedure for making an analysis for one month:

$ Amount of Daily Regional Draw Down of A Branch	Date Drawn	Should Clear	Actually Cleared	Days	$ Days
100,000	1/3	1/4	1/6	2	200,000
50,000	1/4	1/5	1/6	1	50,000
1,000,000	1/5	1/6	1/8	2	2,000,000
	etc.				
			Total $ Days		2,250,000

$2,250,000 ÷ 31 days = 72,580. or approx. 72,000.

The average daily loanable balance for the next two months (Feb. and Mar.) is calculated similar to above. If the average for Feb. is 68,000 and for Mar. is 89,000, then the average for Jan, Feb, & Mar would be:

$$\frac{72,000 + 68,000 + 89,000}{3} = 76,333 \text{ or approx } 76,000$$

Therefore the April daily reginnal draw down for the branch would be 76,000 - 5,000, or 71,000. The average is reduced by 5,000 since the daily average loanable balance is usually kept at 5,000 or less.

5. There will be times when the branch cashier will not be able to deposit enough funds to cover the previous days overdraft amount. When this occurs, a Morgan draft or Bank of American check, depending upon branch location should be deposited for the difference bringing the book balance to zero. The region will then draw down the overdraft amount which will bring the closing balance to a credit balance.

6. Branch overdrafting example:

Overdraft Amt.	50,000
Day #1	
Branch Checking A/C Bal.	-0-
Customer Checks Deposited	100,000
Closing Bal.	100,000 DR
Regional Draw Down With O/D	150,000 CR
Closing Bal.	50,000 CR
Day #2	
Opening Bal.	50,000 CR
Customer Checks Deposited	250,000 DR
Balance	200,000 DR
Regional Drawn Down With O/D	250,000 CR
Closing Bal.	50,000 CR

7. If the average daily loanable balance exceeds $5,000., the branch or regional manager will be advised to overdraft on a daily basis an amount that would bring the average daily loanable balance down to the pre-determined figure of $5,000 or less.

III Maintenance of Checking Account Files

When a new checking account is opened, the following procedures apply:

1. Authorized signature cards (EXHIBIT #5) are filled out by the branch manager and sent to New York for additional signatures and approval.

2. Prepare an Empowering Certificate (EXHIBIT #6) and provide EFH's Corporate Banking Resolution (EXHIBIT #7).

3. Inform branch manager of general ledger account number that has been assigned to the new account. Also inform the Accounting Dept. of the account number assigned by the bank to EFH for the purpose of updating their name and address card file.

4. Maintain and update authorized signatures by keeping files on all bank accounts.

5. When an account is to be closed, write a letter requesting that the bank officially [illegible] our account on their records.

[COPY]

TO: Atlantic Region Cashiers/CBOMS
FROM: Richie Lee
DATE: June 18, 1985
SUBJECT: Interim Authorized Drawdown Sheet

The attached is a temporary drawdown worksheet that must be used in place of the previous worksheet. You will noticed it contains the major points covered by Art Jensen's wire of 5/31/85, further review will show this to be easier to execute. To clarify any possible misunderstandings, let me describe two lines as they relate to your present terminology:

New sheet line 2 = Group 1 checks
New sheet line 9 = Group 2 checks

This sheet should be used immediately upon receipt. Be sure to make copies of this plan for further use. Do not, repeat, do not throw out the old worksheets: once your bank consents to our application of the old worksheet we will return to using it.

Last, but mot important, be sure to mark the case and office on the top of the page so we in the region know who sent it.

(SIGNED) Richie

cc: Art Jensen
Jim Kelly
Bob Harlem (unreadable)
Micro Teta (unreadable)

TO: Atlantic Region Cashiers/CBOMS
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Richie

cc Art Jensen
Jim Kelly
Bill Naylor
Mirco Teta

E.F. HUTTON & COMPANY INC.
STANDARD BANK CONSENT

_____________________________ (the "Bank") agrees that E.F. Hutton & Company Inc. ("Hutton") may from time to time draw against uncollected funds in its depository account(s) number _____________________ (the "Account(s)"). The Bank further agrees that Hutton may from time to time draw depository transfer checks against the Account(s) in amounts greater than the funds received from Hutton's customers or institutional clients in the ordinary course of business and deposited in the Account(s).

The Bank may charge Hutton its prevailing charges (in fees or balances) for drawings against uncollected funds, and this consent shall not be construed as a waiver of such charges.

This consent is revocable at any time at the Bank's option. Revocation of consent may apply to a single transaction, to a series of transactions, or to the entire operation of (any or all of) the Accounts(s).

Bank: ___________________________

By: ___________________________

Name:
Title:

Date: ___________________________

Mr. HUGHES. I would ask you if you ever saw this memo before.

Mr. HOLLAND. Do you have any idea of the date of this memo?

Mr. HUGHES. I am sorry, we have no cover, no indication of who it went to, but it would appear to be a memo that was, in fact it appears to be perhaps a part of a manual, maybe a training manual.

It looks like it has been reproduced. It is not typed. It is printed. It goes into some detail about overdrafting. It appears to set down policies for branch managers to follow. Have you seen this before?

Mr. HOLLAND. No, sir, I have not seen this before.

Mr. HUGHES. So you cannot help us.

Mr. HOLLAND. There was, as I stated earlier in my testimony, a point when I went to a training session about the maximum utilization of your funds in your banking account, but I don't recall seeing this specific memo.

Mr. HUGHES. I refer you to in particular subsection II, Branch Overdrafting, paragraph 1. "The object"—I read from about two-thirds the way down:

> The object is to draw down daily a sufficient amount from the average daily loanable balance an amount that would create an overdraft (credit balance) in the EFH books but at the same time because of the float factor, not enough of a drawdown to cause an overdraft in the bank's books.
>
> This daily overdraft figure for each account can be increased or decreased according to subsequent bank analysis.

Was that company policy? Was that something you had been advised should be policy of branch managers?

Mr. HOLLAND. During the period in question, I believe—I had a very good relationship with my bank. I believe there was—it was only twice that our account was ever overdrafted. There was a system, if you will, where we knew exactly when our checks were going to hit and therefore, our account was never overdrafted.

Mr. HUGHES. So your answer is that that basically was policy, even though you cannot identify the document.

Mr. HOLLAND. That is correct.

Mr. HUGHES. Before that, there is a statement based on monthly analysis from records from the branch banks:

> New York will monitor the branch and regional checking accounts and make recommendations to the managers as to the amount they should overdraft.

Was that also the policy that New York would monitor and make recommendations insofar as how much to overdraft?

Mr. HOLLAND. Certainly in terms of monitoring because this information was passed on on a daily basis to either regional and/or New York people. They knew exactly what——

Mr. HUGHES. Who in particular?

Mr. HOLLAND. I don't know, again, sir, and I am not avoiding the question, I don't know who the wires went to. It could have gone to the regional operations for the Atlantic region and/or Hugh van Hengel at the cash desk but wires were sent with specific numbers on a daily basis.

Mr. HUGHES. Certainly you must have been in conversations in regional meetings, on the phone or otherwise received correspondence from people at headquarters on the subject. It became a very important issue in the sense that interest profits at some time became a very substantial portion of the company's income.

Mr. Holland. As I said——

Mr. Hughes. You had no conversations, no communications with anyone in particular at headquarters?

Mr. Holland. The regional meetings that I attended on a semiannual basis, this question was addressed at probably every meeting where there was a certain time allotted as there was for each product area, you know, that contributed to the profitability of the firm. We discussed the fact that there were certain branches that had implemented procedures which were allowing them to significantly increase their interest profits.

Mr. Hughes. I am just trying to find out who at headquarters was discussing it with you?

Mr. Holland. The individual that I recall that handled as part of his duties at the regional meetings would have been again Mr. Alan Rhein.

Mr. Hughes. What was his title?

Mr. Holland. He was a vice president in charge, and regional sales manager within the Atlantic region.

Mr. Hughes. Any others?

Mr. Holland. Not that I can recall.

Mr. Hughes. The gentleman from Florida.

Mr. McCollum. Thank you, Mr. Chairman.

In the process of what you have been describing to us, at some point you got involved but you also indicated, I believe, that the cashier in your office had a lot of relationship with the regional office on the drawdowns. Could you describe for us the drawdown procedure as you knew it to be implemented in your branch?

In other words, did you actually draw down from the local bank that you had the account with and then keep the check or did you send it on or did the region write the check and send it?

When Mr. Sullivan was testifying a moment ago, there was an indication I had that during his tenure the concept in large measure was for the regions to do the actual physical writing of checks on your accounts at the branch outlets, and there was not very much writing of checks at the branch for this drawdown purpose.

It sounds from what you are saying you may well have been writing the checks and drawing down in that sense.

Can you tell us figuratively or literally how this went about?

Mr. Holland. Initially, this developed in phases, of course, initially what happened was I was instructed to open an account on a local bank which I did and send the appropriate corporate resolutions and signature cards to our operations headquarters in New York.

From that point in time they, the appropriate signatories in New York, as well as individuals in Wyomissing, PA, which was the office that initially drew me down, signed——

Mr. McCollum. Is that a regional office?

Mr. Holland. No. That was the parent office of the Wilkes-Barre, PA office.

Mr. McCollum. Fine.

Mr. Holland. And this package was then returned to my bank. My checkbook was then forwarded to Wyomissing, PA in that office, and at the end of the day when my cashier had gone through the machinations of figuring out this drawdown procedure, she would call the Wyomissing office and give them a figure. They would write a check on my bank and deposit it into their bank.

Mr. McCOLLUM. Later on that changed?

Mr. HOLLAND. That is correct.

Mr. McCOLLUM. Now let me ask you this. When again—would you repeat when did you start working in the Wilkes-Barre office?

Mr. HOLLAND. I opened the office in August 1980.

Mr. McCOLLUM. And you continued there until when?

Mr. HOLLAND. I continued—I became branch manager in September 1980—sorry—in January 1983 we were a full branch and I was branch manager until July 1984.

Mr. McCOLLUM. But you were managing that office even though you were not a full branch.

Mr. HOLLAND. That is correct.

Mr. McCOLLUM. Ever since you were opened up there, you managed that particular office?

Mr. HOLLAND. Once I passed the regulatory exams for agent in charge, yes, I became the manager.

Mr. McCOLLUM. Sometime in late 1980 you were managing that branch?

Mr. HOLLAND. Late 1980 or early 1981.

Mr. McCOLLUM. All right. At some point the check writing system you just described to me changed. When did that change take place?

Mr. HOLLAND. I do not know exactly when it did change. There was at some point where Wyomissing no longer drew us down and we were drawn down by another branch. The date I do not know.

Mr. McCOLLUM. At any rate, it changed. What happened then?

Mr. HOLLAND. Again, our signature—the same procedure which I described to you before went through and a bank, I believe it was Huntington, WV, then was the depository of our checks.

Mr. McCOLLUM. At any rate, they drew you down.

Mr. HOLLAND. That is correct.

Mr. McCOLLUM. So we are talking about not your office or cashier writing checks to draw you down; still it is somebody else in each case using figures that they get on the telephone from either you or your cashier on a daily basis; is that correct?

Mr. HOLLAND. That is correct.

Mr. McCOLLUM. Now, at any time did you use a work sheet such as Mr. Sullivan described to us was his intent when he drew up this scheme of drawdowns?

Mr. HOLLAND. As I pointed out before, from the time—Mr. Sullivan again had left the firm when I came on.

Mr. McCOLLUM. I understand.

Mr. HOLLAND. During the tenure we are talking about, to my knowledge there was three different work sheets that were utilized and I do not know if either was used on a uniform basis or not; but there were three different work sheets used to come up with various figures.

Mr. McCOLLUM. Did you monitor the use of those work sheets?

Mr. HOLLAND. Did I?

Mr. McCOLLUM. You or your cashier use them?

Mr. HOLLAND. My cashier used them. I did not. I did not monitor them.

Mr. **McCollum.** You did look at them? You examined them, you saw them at some point?

Mr. **Holland.** There was, again, a system that had been implemented where sheets were kept month by month where checks were going to, what money came into the account, what the drawdown figure was and what the anticipated date was for when the check was actually going to clear; and as I think Mr. Sullivan mentioned, there were some other checks—if there were not enough funds in there, we put the funds in to make sure.

Mr. **McCollum.** You would go to meetings occasionally, you said. You had meetings with this as the subject; is that correct?

Mr. **Holland.** That is correct.

Mr. **McCollum.** At those meetings did you either on the record, off the record, casually after a meeting with your fellow managers or branch managers discuss the overdrafting, not just what was being given to you in the way of material or what was lectured to you by somebody on high, but did you discuss it among yourselves?

Mr. **Holland.** I am sure that we did in the normal course of business, OK, but it was certainly not a major part of our discussion.

Mr. **McCollum.** Did you have the impression that you should be seeing to it that your cashier, you and everybody working in this process, did everything you could to maximize the amount of interest profits on those accounts when you were in your own branch accounts?

Mr. **Holland.** Yes, that is correct.

Mr. **McCollum.** Was it, indeed, your impression from these discussions amongst yourselves and from what you received from corporate management that, in fact, you should basically do everything you could get away with to maximize those profits?

Mr. **Holland.** That is correct.

Mr. **McCollum.** There was no indication to you whatsoever that you should be consulting with the banks about this, was there?

Mr. **Holland.** Let me give you this analogy. We have a very sophisticated computer system at E.F. Hutton. When one of my brokers buys stocks which are restricted or takes a very large position, I get a wire immediately the following day that makes me aware that there has been either a possible violation or something that has gone wrong that I should attend to.

Never in the course of my dealings nor in the course of my dealings with my cashiers did anyone ever send me a wire saying that my drawdown procedures were out of order.

Mr. **McCollum.** All right. One last area of questioning and my time is about up, Mr. Holland.

Did you know Art Jensen, Arthur Jensen?

Mr. **Holland.** Yes, I do.

Mr. **McCollum.** In what way did you know him?

Mr. **Holland.** Mr. Jensen was the regional operations manager for the Atlantic Region.

Mr. **McCollum.** And did he have contact with you at some point indicating to you that you were going to be empowered to draw on other branches?

Mr. **Holland.** Yes, he did.

Mr. **McCollum.** When did that happen?

Mr. HOLLAND. Mr. Congressman, I do not remember the exact date at what point. I believe it was sometime in the summer of 1981, but I cannot be positive.

Mr. McCOLLUM. Was this a telephone call or writing or——

Mr. HOLLAND. A telephone call.

Mr. McCOLLUM. What did that mean? Did that mean you were going to be writing checks yourself on other branches or what?

Mr. HOLLAND. The conversation that took place was basically that I would be drawing down three New York City branch offices and that I would be receiving signature cards and appropriate forms I would have to sign and anyone else in my office that would be signing checks would have to sign, we would return these to New York.

Mr. McCOLLUM. You would actually be doing this?

Mr. HOLLAND. Yes.

Mr. McCOLLUM. Did not this seem strange to you, unusual and new?

Mr. HOLLAND. Please, sir?

Mr. McCOLLUM. Did not this seem strange, unusual, new to you?

Mr. HOLLAND. It was certainly new to me when I get a corporate resolution and get signature cards that I am going to be drawing down other offices.

Mr. McCOLLUM. You were not a full branch at that time, were you?

Mr. HOLLAND. No, I was not.

Mr. McCOLLUM. Had you ever heard of any other branch doing anything like that before?

Mr. HOLLAND. Yes, I had.

Mr. McCOLLUM. Where?

Mr. HOLLAND. I believe it was in Wyomissing.

Mr. McCOLLUM. How did that come to your attention, that the other branch was doing the same thing?

Mr. HOLLAND. I do not recall. I just remember in some point a conversation and I cannot absolutely be correct it was Wyomissing, but that there were other branches being drawn down.

Mr. McCOLLUM. You did not question Mr. Jensen when he gave you this authority as to, hey, why am I being asked to do this? Is this not kind of strange for somebody who is not even a branch to be going out and getting involved in this? You did not question him about it. You just said, hey, I am going to do it.

Mr. HOLLAND. I do not recall what my actual remarks were to Mr. Jensen at that point in time. I knew that just as I had been drawn down by another branch office and had heard of other branch offices drawing down other branches that it was part of a corporate cash management and I was selected to do it.

Mr. McCOLLUM. Is this all part of getting away with whatever you could to make a profit on the interest in your view?

Mr. HOLLAND. No, I think my—my understanding at that point in time was that the checks in the New York City branches were clearing very rapidly and that my checks were not clearing very rapidly and therefore by depositing the checks in my bank that it would allow the New York branches to make interest profit.

Mr. McCollum. Mr. Chairman, I have asked a lot of questions. I know there will be many more in this same area, but I do not want to impose on all the other members.

Mr. Hughes. The gentleman from Florida, Mr. Smith.

Mr. Smith. Thank you, Mr. Chairman.

I have read over the statement, Mr. Holland, that you made during—or statements, conversations you had in the staff interview. I want to commend you for your candor. Do you consider yourself to have been used by E.F. Hutton?

Mr. Holland. No, I do not, sir.

Mr. Smith. You still working for E.F. Hutton?

Mr. Holland. I am.

Mr. Smith. As a branch manager in Colorado, Boulder, CO?

Mr. Holland. That is correct.

Mr. Smith. Are you displeased at all with the characterization that Hutton has made of some branch managers as being overaggressive or that they were "off the reservation" in carrying on these types of aggressive drawdown policies?

Mr. Holland. I think, sir, that when the initial problem arose there was a lot of confusion as to who was what—who at certain levels in the company was making some statements, and in my position where I felt that someone, that I was following corporate procedures, which I believed to be ethical, correct and legal, and then at some future date to be put in a position where I am being told that in your words I am off the reservation, I was somewhat concerned about those types of remarks being directed to me.

Mr. Smith. Did you ever make a conscious decision on your own to draw down another branch's bank account?

Mr. Holland. Absolutely not.

Mr. Smith. Did you ever print up checkbooks on your own which were the bank account checkbooks for other branches?

Mr. Holland. Absolutely not.

Mr. Smith. You received those corporate resolution cards and signature cards for other banks so you could draw down those checks. Did you solicit them from anybody?

Mr. Holland. Absolutely not.

Mr. Smith. They were sent to you by whom?

Mr. Holland. Sent to me by the region, by the Atlantic region.

Mr. Smith. I am going to offer for the record, Mr. Chairman, a memo dated August 5, 1981, directed from George Ball to regional vice presidents, regional sales managers and branch office managers; and if that could be given, dated August 5, 1981, to the witness so that he could review it. I will read it, Mr. Holland.

Mr. Hughes. Without objection, it will be made a part of the record.

[The information follows:]

EF Hutton

INTER-OFFICE MEMORANDUM

TO Regional Vice Presidents
Regional Sales Managers
Branch Office Managers

FROM George L. Ball

DATE August 5, 1981

SUBJECT Operating Profit

High fences make good neighbors and high interest profits create good margins. However, interest levels are a two-edged lord; they can go down as well as up. When they do, the impact on the bottom line of many branches will be a grave one.

An outstanding branch should have operating margins of at least 10% (and preferably 12%). These, coupled with net interest income, can provide a splendid pool of profits even when interest spreads narrow. However, too many offices today are generating operating margins far skinnier than the 10% or more desired. ①

If your office is one of these, a sound dose of gross improvement or cost control is prescribed.

George L. Ball

GLB:pz

FC 14A (REV. 3/78)

Mr. **Smith** [reading].

Subject: Operating Profit. High fences make good neighbors and high interest profits create good margins. However, interest levels are a two-edged lord"—I suppose they mean sword, although that could be a Freudian slip—"they can go down as well as up. When they do, the impact on the bottom line of many branches will be a grave one. An outstanding branch should have operating margins of at least 10 percent—and preferably 12 percent. These, coupled with net interest income, can provide a splendid pool of profits even when interest spreads narrow. However, too many offices today are generating operating margins far skinnier than the 10 percent or more desired. If your office is one of these, a sound dose of gross improvement or cost control is prescribed.

Were you in the habit of getting memos that were this direct?

Mr. **Holland**. Well——

Mr. **Smith**. Not you, but generically, branch managers in general?

Mr. **Holland**. Yes, we were, sir.

Mr. **Smith**. Did you consider these memos to be threatening or just corporate attitude, way to go and rah-rah memos?

Mr. **Holland**. Well, my personal understanding of this memo was that in times of declining interest rates where many branch managers had relied upon interest profitability that we should have paid attention to cost control and increasing the production, get more productivity out of our account executives as part of our overall corporate structure to increase profitability.

Mr. **Smith**. So this was actually something that was directed to other than drawdowns and having to do with any significant interest profits?

Mr. **Holland**. That is the way I took it, sir.

Mr. **Smith**. Did you ever get any memos like this from Mr. Ball relating to interest profits from excessive drawdowns?

Mr. **Holland**. We received numerous memos from various people in New York. I do not specifically recall seeing one from Mr. Ball, but we did get numerous memos reminding us of certain situations.

Mr. **Smith**. Were they all from upper corporate level management?

Mr. **Holland**. Not all of them.

Mr. **Smith**. Were there some from upper corporate level management?

Mr. **Holland**. I would say yes.

Mr. **Smith**. Did you ever discuss the aggressive drawdowns? Let me back up a little. Can you give me an example of what you consider to be aggressive drawdown, something that would have been something that you would be doing in the normal course of business, say, in 1981 or 1982 before this scheme came to the attention of others? For instance, how much would you anticipate and draw down from, say, tomorrow's account or today's balance?

Mr. **Holland**. Again, sir, the formula for the drawdown was so complicated. OK; I do not think most of the people involved in it actually understood it because it involved many, many facets of different items.

In terms of the—when you say give you an example of what I would consider to be aggressive, there were certain patterns, if you will, that had been established. The only point I might make here in terms of using your terminology of what would be aggressive is where we would have received a memo on a holiday weekend that, you know, would have alluded or specifically said take a healthy drawdown because it is a 4-day weekend to, you know, round your numbers up or something like that.

Mr. **Smith**. Does healthy drawdown mean withdrawing by check to another, whether it is the region or whatever else, so much far in excess of what was then the balance in the bank?

Mr. **Holland**. I would have taken it to have meant that, you know. The numbers could have been rounded up significantly from where they were.

Mr. **Hughes**. Will the gentleman yield to me?

Mr. **Smith**. I would be happy to yield.

Mr. **Hughes**. While you are talking about the memorandum, I wonder if the gentleman would offer the memo of October 1980 dealing with that interest profit.

Mr. **Smith**. I will offer that memo, October 27, 1980.

Mr. **Hughes**. Without objection, it will be inserted in the record.

Mr. **Smith**. It has a cover letter from George Ball, a memo from Joe McAdams and Gene Cahalan regarding net interest profits.

[The information follows:]

A 10-11

EF Hutton

EF Hutton & Company Inc
One Battery Park Plaza
New York, New York 10004
Tel. (212) 742-6744

Memo from George L. Ball

10/27/80

To: Regional Vice Presidents
Regional Sales Managers

This is a well-written primer on cash management for the branch office.

George
/jdv

Inter-Office Memorandum

EFHutton

[illegible]

TO All Branch and Satellite Managers

FROM Joe McAdams/Gene Cahalan

SUBJECT Net Interest Profits

DATE October 21, 1980

Net interest profits are a vital aspect of every branch's profitability. In leaner times they sometimes represented the difference between a profit and a loss for a branch. Fortunately this is not true today, however net interest profits still account for approximately 50% of the average branch's profits. And by paying insufficient attention to net interest profits, a branch may be ignoring potential revenue that would be brought directly to the "bottom line".

This memo gives an overview of the primary ways that net interest profits are generated, and it provides a list of suggestions that could improve a branch's net interest profits. This list is by no means all-inclusive, and it would be appreciated greatly if any additional suggestions could be sent to us.

Interest profits are derived from four main categories:

1. Margin Accounts. The branch is credited with the charge to customer, which ranges from ½% to 2½% above the call loan rate. In turn, the office is charged with the call rate cost of the money.

2. Short Positions. The branch receives the full call rate on both the proceeds of the short sale and the additional margin, if any, put up in cash by customers as a result of the short. There is no charge to the branch. For example, if a customer sells short 100 shares at 50, and deposits in cash the required 50%, the office is credited with the call rate on $7,500. However, where a customer sells short at 50 and uses SMA rather than depositing new money, the credit will be based on only $5,000.

3. Free Credit Balances. These are customer net settled credit balances in cash and margin accounts. The branch is credited with the call rate on free credit balances, and is charged with cash account debit balances after settlement date.

4. Interest on General Ledger Balances. The branch earns interest on all credit balances in its general ledger and is charged for all debit balances, both at the call rate. The lion's share of the interest profit generated in this category is due to the float earned on BOA checks and overdrafting the branch's bank account.

(Note-For the first nine months of 1980, the first three of the preceding categories accounted for approximately 55% and the fourth for approximately 45% of the Southeast Region's net interest profits.)

The following are suggestions that could increase your interest profits:

1. Develop short sales. The profit impact of short sales, including shorts against the box, are obvious. The net interest profit impact of a short sale can be over ten times the impact of an equal dollar amount of a margin debit.
2. Develop more margin accounts. The branch earns the difference between the rate the customer is charged and the call rate.
3. Improve branch profitability. As noted earlier?, the branch earns interest on all general ledger credit balances and is charged for all debit balances at the call rate. Thus improved profitability, through either cost reduction (lower net debits) or increased production (higher net credits), will also lead to higher net interest profits.
4. Overdraft the branch's bank account. A memo on this subject was sent to all branch office managers on 10/7/80.
5. Insure that Cash Reserve is liquidated on settlement date, not on the extension day. If Cash Reserve is liquidated on the extension day, the customer has unjustly earned and the branch has been charged with two days interest.
6. Always pay BOA drafts rather than local checks. The branch earns interest until the BOA draft clears. The use of local checks also has an adverse effect on a branch's ability to overdraft its bank account.
7. Delivery vs. Payment (DVP). As a matter of policy, no DVP should be accepted for any individual customer's account, even though it may appear to be a bank DVP.

DVP's continue to cost each branch thousands of dollars in interest per year. The interest charges often are virtually equal to the commissions earned on these transactions.

The manager, before approving any account that qualifies for DVP, such as banks, investment companies, insurance companies, or corporations, should ascertain that the A/E has given the Margin Department proper standing instructions so that delivery vs. payment can be completed by settlement day.

8. Strengthen procedures to collect customer payments for cash accounts on, or before, settlement date. Try to convince the AE's that it is easier to call their customers with net figures on trades so as to avoid disagreements over net interest charges beyond settlement date, particularly when they know that:
    - a. Confirm will be late.
    - b. Customer is traditionally slow in paying.
    - c. Customer lives in an area with poor mail service.
    - d. There is a large amount of money due.
    - e. It is a Syndicate item.
    - f. CBOE options - - settle next day. The settlement date is the date interest is charged for inter-branch purpose.
    - g. Trade hits wrong account.

9. Review the branch's Type I Interest List. Determine what AE's are lax in getting their customers to settle on time and discuss the reasons for this with them.

10. Review the branch's Fixed Rate Interest List. Are the reasons these concessions were based on still valid? (i.e. lower rate in return for a certain level of expected production or balance in an account.)

11. Transfer free credit balances in "flat" commodity accounts to stock accounts. The branch earns nothing on free credits in commodity accounts, but it does on stock accounts.

12. Be hesitant to prepay commissions due an AE. Since the branch is charged interest at the call rate for this, you are making an interest-free loan to the AE.

13. Try to mail confirmations as early in the day as possible. (before 10 A.M.)

14. Attempt to mail drafts late in the afternoon. The branch may earn an extra day of float by doing this.

15. Discourage automatic dividend payouts whenever possible in cash accounts, and encourage automatic dividend payouts in margin accounts.

16. Suggest that the AE's mark cash account sales "XS" unless the customer specifically request that the proceeds be mailed out on settlement date. This has the additional benefit of keeping funds in the account for reinvesting.

17. Convince AE's not to mail out small credit balances at the end of the month, unless the customer requests that they receive small credits, or if the account is flat on positions and the money is under $100.00. This will also save on postage. (Double savings.)

18. Be reluctant to write off debit interest for late payments, especially if an extension was obtained or CRM was sold late.

19. Be judicious in adjusting interest on Cash Reserve orders.

Joe Gene

GC/kb

cc: R. Williams
J. Daniel
C. McIntire

Mr. **Smith.** Have you seen this one before?

Mr. **Holland.** I am sure it passed over my desk. If it was addressed to all branch managers, yes; and if you are talking about the interoffice memorandum from Joe McAdams——

Mr. **Smith.** Yes. The cover letter is nothing more than just from the president saying, commending it to your viewing, but obviously the memorandum is the operative portion.

Mr. **Holland.** I cannot tell if this was a regional—it appears to me because of the name Joe McAdams that this was an interregional letter rather than one throughout the company. So I may not have seen this.

Mr. **Smith.** You may not have seen it? It is directed to all branch and satellite managers.

Mr. **Holland.** But it appears because of the name—Mr. McAdams was a regional operations manager in a different region, so the analogy would be if in my region that I am now or Atlantic Region, a letter came to managers and satellite managers, it would be specifically directed to those within that region and not the whole company.

Mr. **Smith.** So you do not recall seeing this memo, the interoffice memo detailing the net interest profit and the way to make them as high and viable as possible?

Mr. **Holland.** Well, I——

Mr. **Smith.** It is 5 years ago, I understand that.

Mr. **Holland.** I cannot tell you whether I did or I did not.

Mr. **Smith.** Would you say then that your decisions with reference to the drawdowns, whether it was your own or somebody else drawing you down or when you drew on other banks ultimately when they put you in that position, were based on information passed on to you by other money managers and you did not have to sit and calculate every day your own kinds of drawdowns?

Mr. **Holland.** Again referring back to my earlier remarks, that I believe that what I was doing was legal, was ethical and a part of company policy that had been promoted by my superiors——

Mr. **Smith.** Did the company tell you it was legal and ethical? Is that where you got the opinion, rather than going to a private attorney and asking for an opinion yourself? I am not attempting to catch you. It would be a surprise if you went to your attorney to ask for a private opinion on what E.F. Hutton's attorneys had told you.

Mr. **Holland.** My decision was that I worked for one of the most prestigious firms on Wall Street and one of the finest financial consulting firms and that they, internal counsel, and within management would have examined this very meticulously before it would have been passed down to my level.

Mr. **Smith.** So you relied on what E.F. Hutton told you and your confidence in the company?

Mr. **Holland.** Exactly right.

Mr. **Smith.** When you went to various meetings, you already answered the question, you discussed at some point during the normal discourse of business the net interest profits and the like. Did you get the impression that this was only a regional or local operation or were you under the distinct impression or had heard that this was coming from the top?

Mr. **Holland**. As Mr. Sullivan testified earlier, we are very autonomous in the way the company is set up. Each region has its own policies on how things are handled. So my attention and my interaction was only within my region and I had no other interaction with other regions' personnel.

Mr. **Smith**. This memo we just entered in the record and showed you a copy of, you indicated already probably was an interregional memorandum; is that correct?

Mr. **Holland**. That is correct.

Mr. **Smith**. Would a regional manager have the authority as far as you know to make interregional decisions or would that have to come from higher up other than the regional manager level?

Mr. **Hughes**. A regional—the individual who ran a particular region would have the authority to make within guidelines certain recommendations to his region.

Mr. **Smith**. I am saying interregional, not intraregional. Could a regional manager make interregional decisions or would that have to come from higher up?

Mr. **Holland**. I do not know; I cannot answer that question.

Mr. **Smith**. All right.

Mr. **Hughes**. The gentleman's time has expired.

The gentleman from Kentucky is recognized for 5 minutes. We are going to try to abide by the 5-minute rule; otherwise, we will be here next week.

Mr. **Mazzoli**. I appreciate that, Mr. Chairman.

Just a couple things. Mr. Holland, I asked this same question of Mr. Sullivan when you were in the room. Do you feel, if not abused or misused by E.F. Hutton, do you feel queasy or unhappy about the way this thing has materialized in the sense not so much of the aftermath which everybody is unhappy with but that perhaps at some point they should have given advice to guys like you who were the loyal soldiers carrying out the orders, given you some appreciation for the fact that this was at least skating along the edge of respectability and legality?

Mr. **Holland**. Sir, that never came into any question in my mind until ultimately the situation that we are now in was involved.

Mr. **Mazzoli**. So long as it was being orchestrated as I think it must have been from New York, you were satisfied that they were going to protect you or it was legal, one way or the other?

Mr. **Holland**. I believed that.

Mr. **Mazzoli**. Thank you.

One of the things you said was very revealing, because Mr. Sullivan was here and we talked about chaining, which our distinguished chairman inquired after, suggested that chaining was not really meant to delay the clearance of checks but to expedite them. Yet if I understood you correctly, Mr. Holland, your advice for the reason that Wilkes-Barre cleared three agencies or offices in New York City, including one which was located apparently actually in the corporate headquarters, was because their checks were clearing too fast. Could you help me a little bit. Do you see—first, was that the explanation for putting Wilkes-Barre into this thing?

Mr. **Holland**. As you gentlemen on the committee know, your learning curve after working with this increases significantly. At that point in time——

Mr. **Mazzoli**. Sensitivity increases a little bit for, I think, all of us for that matter, yes.

Mr. **Holland**. At this point I do not know if I was told that that was the reason they were given to me. In retrospect, I now know that the New York City branches, their checks, because they were in Manhattan, were clearing overnight and that by moving them to Wilkes-Barre, because they were slower there, that that allowed those branches to make interest profits.

Mr. **Mazzoli**. So despite what Mr. Sullivan said during his tenure setting up this very circuitous, tortuous almost path for a check to clear, in fact, that was designed to slow down the transactions at the bank in order that, as my friend from Florida brought out very clearly, as each day in this week went on everybody could parlay this, kite it as we say in the trade, parlay this $50,000 into several million dollars perhaps. Is that correct?

Mr. **Holland**. Well, I don't know if it was so much the sense that it was being parlayed, but it allowed those branches in New York to earn interest on funds that they had in their account.

Mr. **Mazzoli**. Which they couldn't have done if the checks cleared quickly.

One irony, Mr. Chairman, is we spend a lot of time in Congress and probably quite a few millions of dollars trying to arrange a Federal Reserve System which will clear checks quickly, and here we have Wilkes-Barre drawing down some agency out in Wyoming, crossing who knows how many Federal Reserve zones.

Mr. **Holland**. We never—everything that the drawdowns—never went outside of our region, to my knowledge. That was Wyoming, not Wyomissing.

Mr. **Mazzoli**. All right.

The Federal Reserve region, then, is extending from Wilkes-Barre to Wyoming?

Mr. **Hughes**. It is Wyomissing, PA, is the name of the community where the witness is referring to.

Mr. **Mazzoli**. Wyomissing, PA, I see.

Let me ask you this. You mentioned, Mr. Holland, and I can understand, as a businessman, you are one of the few managers who apparently was also a salesman or kept in touch with your clients, so you had a lot of busy days. I can understand where you might not know what your cashier did.

Would you have known if that cashier were bilking you of money or if that cashier were out destroying the reputation of your branch of E.F. Hutton?

Mr. **Holland**. It would have depended on the context of how you put that in. There was a system, as I pointed out, where in terms of the cashier, she had a very systematic approach for reporting the daily activity that went on in the branch which she turned over to a wire operator, which was wired to New York.

Mr. **Mazzoli**. I can understand that partly. I can understand where you may not know precisely the person with whom she dealt, precisely the form and all the machinations she would go through, but it seems since you were at some point making as much as 10 percent of that interest income, that you would probably have had some little more contact with it than maybe it would appear that you have from your testimony.

Was she like a sole operator, a lone ranger entirely in this? Wouldn't you have been curious, because you get 10 percent of what she is dealing with?

Mr. **HOLLAND**. Just to recall, during the period in question, I did not get 10 percent of what was happening. As a part of a startup operation, I was made aware by the firm when I took over and decided to manage this office that this office was probably going to be losing money for as long as 2 years.

I did pay attention. I looked at her summary sheets of what was drawn down and the amounts.

Mr. **MAZZOLI**. Reason I ask this, you have not been here for these hearings, but every level of authority seems to be looking the other way. What I have called plausible deniability seems to have been the rule of the road from the corporate offices on Wall Street all the way down to the branch manager.

It seems like that at this particular stage and no other stages. I am sure you knew when your salesmen were abusing a client, and you tell me, as you tell the committee, you had sophisticated computers in New York that would tell you tomorrow if one of your salesmen were on the edge of the SEC violation today. You know that, but somehow, when it came to millions upon millions of dollars being kited all over the place, in and out of offices and 50,000 different accounts, checkbooks all over the place, checks with smudged numbers that delayed clearances even more, in fact someone would know what the hell was going on.

Can you explain that to me? Where am I going wrong? Why can I not understand this?

Mr. **HOLLAND**. In terms of my relationship with my cashier, and looking at her monthly drawdowns, I can peruse that like looking at a calendar and say this is how much was drawn down on a particular day.

There were occasions where I would have received, say, a memo that said, all right, we have a 4-day weekend; let's make sure we round, take a healthy roundout in the numbers where I might have increased that drawdown, OK?

But in terms of the system itself, that was in place, that dealt between my branch and New York and the dealings with the actual funds, I was never, ever concerned that my cashier would bilk me.

Mr. **MAZZOLI**. I understand.

The chairman needs to move on, but I have two things.

With all due respect, I don't find that particularly persuasive. I certainly didn't find Mr. Fomon's statement, or Mr. Morley's, persuasive that they didn't know what was going on really.

I think the genesis was in the boardrooms in New York City. I think that the orchestration of it was in the boardrooms of New York City.

I think the fine control through the sophisticated computers and memos, like Mr. Ball's memo, which were not just simply extortion, those were pure and simple threats.

It all goes back to the boardroom, but because of the way this thing has been set up, the magic of it, the beauty of it, as I saw often in my service on the House Intelligence Committee, was it is plausibly deniable every step of the way. It is just something—I really worry about such a thing, particularly in a fiduciary activity.

Thank you, Mr. Chairman.

Mr. **Hughes**. The gentleman from Connecticut is recognized for 5 minutes.

I might say that the Chair intends to recess for lunch at 1 o'clock. Hopefully we can finish the testimony from this witness before we recess.

The gentleman from Connecticut.

Mr. **Morrison**. Thank you, Mr. Chairman.

Mr. Holland, first, during this period that we have been talking about where you were the branch manager in Wilkes-Barre—do you have your own checking account?

Mr. **Holland**. Yes, I do, sir.

Mr. **Morrison**. You regularly sign checks on your own checking account?

Mr. **Holland**. Yes.

Mr. **Morrison**. When you did that, were you concerned about how much money was in the bank when you wrote the check?

Mr. **Holland**. Yes.

Mr. **Morrison**. And did you worry at all about, if there wasn't money in the bank and you signed the check that you might have some responsibility?

Mr. **Holland**. Yes.

Mr. **Morrison**. Well, that is what I don't understand. You had experience signing checks; you knew something about personal liability.

You were signing a whole lot of checks, drawing down these three banks in New York, for instance, and somebody told you, "Write a check for *x* dollars on drawing down one of those branches." You just wrote—you wrote it, signed it, sent it off. You didn't care what the basis of that check was. You didn't feel you had any personal responsibility?

Mr. **Holland**. No; I work for a firm that had $7 billion in assets and that in the process of what I had done on the local level, where I had never overdrawn any account and——

Mr. **Morrison**. Hang on a second. Which is it, that you didn't have to know whether the check was good that you were signing, that you were shielded by some corporate, kind of corporate immunity, that there was no liability for writing a check that might be an illegal instrument in some way? Was that your—had you been told that? Was that the way you believed the world worked?

Mr. **Holland**. My belief was that when somebody called me up, because of the system in place, and said, "This is the dollar amount that you are supposed to write this check out for," that is what I did. It wasn't my place to call up and say, you know, "What is the rationale behind writing this?"

Mr. **Morrison**. You felt that you understood the system so that there was no risk to you that you might, day in and day out, writing all these things, no one might come back to you and question whether you had written a check which was inappropriate, where there were no funds?

What is it? Is it that you thought the corporation took all liability, you had no personal liability?

Mr. **Holland**. To this point, I still feel I had no liability.

Mr. **Morrison**. It seems the Justice Department proceeded that way, but it seems the committee is somewhat concerned about whether that was the correct way to proceed.

Perhaps we can get at this a little bit if, Mr. Chairman, if we could at this point in the record introduce the Justice Department's financial analysis for the Wilkes-Barre branch, and we could question Mr. Holland about that.

I believe, Mr. Holland, you were provided a copy of this document before the hearing.

Mr. **Holland**. Just before we walked in the door, yes.

Mr. **Morrison**. I understand this is not an internal E.F. Hutton document, but do you understand—by reviewing it, do you understand this document? Do you understand what it is, what it purports to be?

Mr. **Holland**. I believe I do, sir.

Mr. **Hughes**. Will the gentleman yield to me?

Does the gentleman intend to put it in the record?

Mr. **Morrison**. Yes, Mr. Chairman, thank you.

Mr. **Hughes**. Without objection, it will be received in the record.

[The financial statement follows:]

E.F.Hutton Wilkes-Barre, PA Branch United Penn Bank (1050-1163)

Bartow Park Blvd 950 3rd Ave

DATE	Customer Deposits	Chks to 12/4 UST Chk	Wires In	A-19	A-16	White Plains A-24	Drawdown for AH DK & Trust	Chk No.	Paid Date	DR(CR)	Book Balance
01-Nov-81											(2,497,925.71)
02-Nov-81	23,325.68	2,476,000.00					300,000.00	205	11/4		(298,600.03)
03-Nov-81	108,213.59	192,000.00					400,000.00	206	11/6		(398,386.44)
04-Nov-81	34,473.37	363,000.00					500,000.00	207	11/6	(2,200.00)	(498,711.07)
05-Nov-81	17,015.68	483,000.00					1,500,000.00	208	11/9		(1,498,695.39)
06-Nov-81	122,635.49	1,378,000.00					2,500,000.00	209	11/9		(2,498,059.90)
07-Nov-81											(2,498,059.90)
08-Nov-81											(2,498,059.90)
09-Nov-81	67,423.84	2,432,000.00					300,000.00	290	11/12		(298,636.06)
10-Nov-81	146,793.65	153,000.00					450,000.00	291	11/12		(448,842.41)
11-Nov-81	95,025.00	355,000.00									1,182.59
12-Nov-81	31,961.92						1,500,000.00	292	11/16		(1,466,855.49)
13-Nov-81	94,194.85	1,375,000.00					2,500,000.00	293	11/16		(2,497,660.64)
14-Nov-81											(2,497,660.64)
15-Nov-81											(2,497,660.64)
16-Nov-81	231,172.57	2,443,000.00					300,000.00	294	11/16		(123,488.07)
17-Nov-81	63,227.01	62,000.00					450,000.00	295	11/18		(448,261.06)
18-Nov-81	33,669.92	416,000.00					525,000.00	296	11/19		(523,591.14)
19-Nov-81	96,305.75	429,000.00					1,500,000.00	297	11/20		(1,498,285.39)
20-Nov-81	178,471.67	1,322,080.00					2,500,000.00	298	11/23		(2,497,733.72)
21-Nov-81											(2,497,733.72)
22-Nov-81											(2,497,733.72)
23-Nov-81	186,026.15	2,313,000.00					350,000.00	299	11/27		(348,707.57)
24-Nov-81	34,221.16	316,000.00					425,000.00	301	11/27		(423,486.41)
25-Nov-81	38,041.95	387,000.00					1,500,000.00	300	11/27		(1,498,444.46)
26-Nov-81											(1,498,444.46)
27-Nov-81	267,395.53	1,233,000.00					2,500,000.00	302	11/30		(2,498,048.93)
28-Nov-81											(2,498,048.93)
29-Nov-81											(2,498,048.93)
30-Nov-81	24,965.85	2,475,000.00					300,000.00	303	12/2		(298,083.08)

E.F.Hutton Wilkes-Barre, PA Branch United Penn Bank (R50-1100)

DATE	Customer Deposits	Chem to 12/4 UST Chk	Wires In	Battery Park Bldg A-19	950 3rd Ave A-16	White Plains A-24	Drawdown to: NK BK & Trust	Chk No.	Paid Date		DR(CR)	Book Balance
01-Dec-81	12,714.18	227,000.00					375,000.00	304	12/3			(373,369.70)
02-Dec-81	17,764.94	357,000.00					450,000.00	325	12/3			(448,604.76)
03-Dec-81	133,082.03			300,000.00	930,000.00	190,000.00	2,500,000.00	609	12/7	*	1,000.00	(1,395,882.73)
04-Dec-81	50,648.30			200,000.00	2,900,000.00	195,000.00	7,000,000.00	611	12/9	*		(5,050,154.23)
05-Dec-81												(5,050,154.23)
06-Dec-81												(5,050,154.23)
07-Dec-81	37,204.83			325,000.00		104,000.00	2,000,000.00	613	uc	*		(6,463,869.40)
08-Dec-81	10,322.64	657,000.00		3,125,000.00	693,000.00		6,000,000.00	614	uc	*		(7,990,346.76)
09-Dec-81	39,504.62			2,125,000.00	225,000.00	97,000.00	6,000,000.00	615	12/11	*		(11,491,762.14)
10-Dec-81	110,204.37	3,000,000.00			392,000.00	166,000.00	3,300,000.00			*		(6,315,477.77)
11-Dec-81	11,406.00			1,125,000.00	2,927,000.00	60,000.00					(8,000,000.00)	5,815,929.11
12-Dec-81												5,815,929.11
13-Dec-81												5,815,929.11
14-Dec-81							* Genessee				(3,500,000.00)	9,315,929.11
15-Dec-81							Country Bank				(9,500,000.00)	18,815,929.11
16-Dec-81							drawdowns.					18,815,929.11
17-Dec-81												18,815,929.11
18-Dec-81												18,815,929.11
19-Dec-81												18,815,929.11
20-Dec-81												18,815,929.11
21-Dec-81												18,815,929.11
22-Dec-81							18,815,929.11 wire					0.00

E.F.Hutton Wilkes-Barre, PA Branch United Penn Bank (059-1100)

Summary:	Customer	Chex/UBT	Wires	A-19	A-16	A-24	Drawdown	DR(CR)
'81Jan	977,001.01	0.00	0.00	0.00	0.00	0.00	967,984.04	9,100.1
Feb	1,310,705.43	0.00	0.00	0.00	0.00	0.00	1,310,703.45	0.0
Mar	1,620,282.09	0.00	0.00	0.00	0.00	0.00	1,620,281.53	0.0
Apr	2,231,476.93	0.00	0.00	0.00	0.00	0.00	2,229,982.47	1,495.0
May	1,392,966.05	0.00	75,000.00	0.00	0.00	0.00	1,555,417.94	8,346.0
Jun	2,044,912.44	1,245,000.00	360,000.00	0.00	0.00	0.00	3,543,000.00	3,487.4
Jul	3,640,673.15	3,963,500.00	0.00	0.00	0.00	0.00	7,775,000.00	31,901.21
Aug	1,646,538.15	9,209,000.00	0.00	0.00	0.00	0.00	10,827,000.00	2,749.00
Sep	1,606,176.52	15,284,000.00	0.00	0.00	0.00	0.00	17,215,000.00	30,615.00
Oct	1,373,444.58	19,833,000.00	0.00	0.00	0.00	0.00	23,150,000.00	5,700.00
Nov	1,094,641.03	20,603,000.00	0.00	0.00	0.00	0.00	29,380,000.00	(2,200.00
Dec	472,012.99	9,301,000.00	0.00	7,200,000.00	8,067,000.00	900,000.00	46,640,929.11	(20,999,000.00
Total:	20,780,754.22	75,438,500.00	435,000.00	7,200,000.00	8,067,000.00	900,000.00	137,137,140.56	(20,887,886.34

Mr. **Morrison**. As I understand it, if you can direct your attention to the page that shows the daily record for the month of December 1981.

Mr. **Holland**. Is that page 2, sir?

Mr. **Morrison**. I am not sure the pages are numbered, but it is the second page of the document, yes.

If we could start here on the third of December and just go through the columns and establish what they are.

Mr. **Holland**. Yes.

Mr. **Morrison**. The first one, customer deposits, I take it those are the deposits from customers' receipts into your branch office; is that correct?

Mr. **Holland**. I believe so; that is correct, sir.

Mr. **Morrison**. There is another, the next column is U.S. Trust check. Do you know what that represents? There is no entry on December 3, but there are for other dates.

Mr. **Holland**. That was the account used in the event that funds were not taken into the account where there was a possibility that my bank account could have been—had insufficient funds that I would deposit the U.S. Trust check into that account to cover the insufficiency. So I would not be overdrafted.

Mr. **Morrison**. This is a zero-balance type account that we referred to repeatedly in these hearings, is that correct?

Mr. **Holland**. I believe that is what you call it.

Mr. **Morrison**. And who drew on that account? Did you have authority on that account?

Mr. **Holland**. Yes, I did.

Mr. **Morrison**. I notice down here on December 10 that an $8 million check was written on that account as a deposit. Did you write that check?

Mr. **Holland**. Yes, I did.

Mr. **Morrison**. Is that——

Mr. **Holland**. It is the branch check.

Mr. **Morrison**. A branch check, $8 million.

Do you write a lot of checks in multimillion-dollar figures?

Mr. **Holland**. This particular check I was instructed to write.

Mr. **Morrison**. That had something to do with the problem that developed in the relationship with the bank, is that correct?

Mr. **Holland**. That is correct.

Mr. **Morrison**. Let's go on and understand the rest of this document, if we could.

We have A-19, A-16, and A-24; those are the drawdowns of the three New York branches referred to?

Mr. **Holland**. Yes, that is correct.

Mr. **Morrison**. Are these numbers, the amounts here, you are just told to write a check for this amount. By whom, the branch?

Mr. **Holland**. Yes, sir.

The branch cashier would call up my cashier and give her a drawdown figure in the amounts you see on those particular days.

Mr. **Morrison**. And the cashier would come to you with a check and you would sign it?

Mr. **Holland**. That is correct.

Mr. **Morrison**. And that was fine enough for you?

Mr. **Holland**. Yes, sir.

Mr. **Morrison**. Now, moving over to the next column we have drawdown. These are the drawdowns that were deposited—drawn on the Genesee Country Bank?

Mr. **Holland**. That looks like something different to me, sir.

Mr. **Morrison**. Excuse me, it says drawdown to—excuse me. As I understand it, these were drawdowns for the first 2 days, that is, on the first and second of December to American Bank and Trust and thereafter Genesee Country Bank drawdowns.

In any case, this was your drawdown, is that correct?

Mr. **Holland**. Yes.

Mr. **Morrison**. The amount drawn down from your branch?

Mr. **Holland**. That is correct.

Mr. **Morrison**. And that was—let's just look at December 4 if we could for a moment. You had customer deposits of nearly $59,000 and out of New York you drew down $268,000 and $2.9 million and $195,000, which adds up to, what, something under $4 million.

Mr. **Holland**. Yes.

Mr. **Morrison**. Quite a bit under $4 million. You wrote a check for $7 million.

Mr. **Holland**. That is correct.

Mr. **Morrison**. How do you get to that kind of a number?

Mr. **Holland**. Again, sir, as the previous—as I previously stated, there was a formula that called upon taking money that was previously in the banking account. I have stated I did not understand the drawdown formula then. I still don't understand it, but it was a combination of taking figures from what was in the banking account, deposits from that day, adding in a multiplication factor for anticipation of future funds and coming up with a number.

Mr. **Morrison**. Let me ask you this. During this particular—on this sheet you authorized, you actually didn't write these checks, somebody else drew you down, right? Who was the bank drawing you down? Who was the office drawing you down?

Mr. **Holland**. On the $7 million?

Mr. **Morrison**. Yes.

Mr. **Holland**. That was a check that was deposited in the Batavia National Bank in Genesee, NY.

Mr. **Morrison**. But some branch office was drawing you down?

Mr. **Holland**. That was the Batavia Branch in Genesee, NY.

Mr. **Morrison**. So you were drawing down these three New York City area banks and you were being drawn down by Batavia, NY?

Mr. **Holland**. That is correct.

Mr. **Morrison**. And you said subsequently you understood this chaining may have had something to do with playing with the float, but at that time that didn't strike you as strange?

Mr. **Holland**. Well, I didn't—again, you know, my background with the undergraduate degree in history was not really attuned to what was in the banking industry at that particular time.

Mr. **Morrison**. I guess what I don't understand is how someone can repeatedly, by some formula, be writing checks of millions of dollars and authorizing, directing the writing of other checks of millions of dollars and saying that, oh, it is just a million. I don't have to understand this.

Isn't there any concern that people could be stealing in the middle of all of this if checks this size—you just get a number from somebody, any dishonest person in the chain could be creating the possibility of some kind of defalcation? Didn't this strike you at all in that way?

Mr. **Holland**. Again, sir, I had been with the firm for approximately 15 to 16 months at this point. How long this procedure went on before I got there, I have no idea, but in the implementation of this and because there was a system of checks and balances where daily reporting was going to New York either operationally, regionally or nationally, I was not concerned.

Mr. **Morrison**. Mr. Chairman, I know I have taken more than my alloted time. I have one other question, but if the chairman wishes to question at this time, I will yield.

Mr. **Hughes**. Go ahead.

Mr. **Morrison**. You are still branch manager, is that correct?

Mr. **Holland**. That is correct.

Mr. **Morrison**. Have you been pursuing getting agreements from your banks with respect to a drawdown formula?

Mr. **Holland**. The branch that I now am responsible for had a banking arrangement before I became a part of it, and there was a package that has subsequently gone out since I became branch manager which they signed and have returned to us.

I have had no negotiations with my bank in terms of drawdown procedures.

Mr. **Morrison**. So they have signed a new form authorizing some procedure by which E.F. Hutton will draw against uncollected balances?

Mr. **Holland**. I am not sure if it was that or if it was part of our going back—I didn't read the documentation.

Mr. **Morrison**. You mean, after all of this, and you are sitting here before a congressional committee asking you whether maybe you should have been indicted, and you still didn't read the document about what procedures are being used to draw down against your bank accounts?

Mr. **Holland**. This was a sealed envelope that I was to deliver to officials at the bank and that is what I did, sir.

Mr. **Hughes**. The gentleman's time has expired.

Let me just, if I might, find out, before we recess here, several things.

When you drew down the New York banks, the Battery Park, Third Avenue Bank and White Plains Bank, NY, you knew that there was some question as to why that procedure was set up.

You suspected there was some reason, some advantage to the company, did you not? You may have thought it was ethical, but you knew there was a good reason for the company to do that and ask you to start signing checks on these three New York banks.

Mr. **Holland**. As I stated before, sir, at that particular time I do not recall what my immediate reaction was. I did not, subsequent to that, either through conversations with——

Mr. **Hughes** [continuing]. There came a time when you knew there was some funny business going on.

Mr. **Holland**. There came a time——

Mr. **Hughes**. Isn't that true?

Mr. **Holland** [continuing]. There came a time when I knew that the reasons why it was being done was because the New York branches could—

their checks were clearing too fast. They could not make interest on it, and by going through Wilkes-Barre, it allowed them to make an interest profit.

Mr. **HUGHES**. You also knew when you drew down $7 million for the $58,000 deposit that you didn't have sufficient funds to cover that, did you not?

And just try to answer the questions yes or no. I am asking specific questions here.

Did you have knowledge that you did not have $7 million on December 4 when you deposited $58,000 into the account? You knew, did you not, that you didn't have $7 million in there?

Mr. **HOLLAND**. Sir, there was $4 million that I had checks that went into my bank on that particular day. OK?

Mr. **HUGHES**. You knew that you had $4 million roughly because you drew down some checks on the New York banks.

Mr. **HOLLAND**. That is correct.

Mr. **HUGHES**. But you didn't have $7 million in there, did you?

Mr. **HOLLAND**. OK——

Mr. **HUGHES**. There was a difference of $3 million at least in there.

Mr. **HOLLAND**. Again, sir, going back to the formula of what was in the opening balance of our bank, there may have been $2 million in there. Again, this was a complicated formula that——

Mr. **HUGHES**. You didn't pay attention to the drawdown sheets after a while, did you?

Mr. **HOLLAND**. I didn't pay attention to them——

Mr. **HUGHES**. They were not used, were they, they were just furnished to you by New York, or you made up the figures, isn't that so?

Mr. **HOLLAND**. The New York figures were furnished to us by——

Mr. **HUGHES**. And there were times you had to make them up, isn't that so?

Mr. **HOLLAND**. No.

Mr. **HUGHES**. You never made up any figures?

Mr. **HOLLAND**. The figures came to you every day automatically.

Mr. **HUGHES**. You never furnished any figures for drawdown?

Mr. **HOLLAND**. From New York, absolutely not.

Mr. **HUGHES**. You never furnished any figures for drawdown in your account on the Wilkes-Barre account?

Mr. **HOLLAND**. On the Wilkes-Barre account, yes. On the New York accounts, no.

Mr. **HUGHES**. I am asking if you made up figures for drawing down your own account?

Mr. **HOLLAND**. Yes.

Mr. **HUGHES**. And that had no relationship to the drawdown sheet, did it, at times?

Mr. **HOLLAND**. I will say yes to that question, on certain occasions.

Mr. **HUGHES**. You just led us to believe a while ago that the drawdown sheets were very confusing, that you really didn't understand them, and that it just, you know, the figures just indicate that there had to be very little relationship. $7 million compared to what the drawdown sheet would have shown is worlds apart.

Mr. Holland. First of all, we cannot tell, because I don't know what the opening balance—if there was $3 million opening balance from the previous day in my account, it had not been cleared. It would have been added back in.

Mr. Hughes. You are telling me, here you are, the branch manager, making decisions and you know enough about maintaining a checking account. Even though you might be a history major, you impress me as a fairly bright individual, and you certainly had to have knowledge that there was some funny business here when you were depositing $58,000 and drawing down $7 million.

You mean to tell me that never put you on notice there was something wrong?

Mr. Holland. As I also stated earlier, sir, these figures went regularly to my superiors, and just as in other facets of my business, when something has gone wrong in my operation and I get a wire and say this is wrong, this should be changed——

Mr. Hughes. You are doing what has been suggested; what you are doing is you are excusing your conduct because that was policy. You were working for a prestigious company, and what you are telling us is you never questioned that practice.

Mr. Holland. That is correct.

Mr. Morrison. Mr. Chairman.

Mr. Hughes. The gentleman from Connecticut.

Mr. Morrison. One thing I would like to pursue that Mr. Holland answered.

You said this depends on what the opening balance was. There might have been $3 million uncollected that had not cleared through there yet, so there might be an opening balance of $3 million.

Mr. Holland. Yes.

Mr. Morrison. But you drew it down earlier. It was there already. You are just talking about whether you draw it down again.

Mr. Holland. Again, as I believe Mr. Sullivan testified at the end, there were factors that were added back into this where the money might have been drawn down on a multiple basis.

Mr. Morrison. My point is that consistent with what has been said over and over again, maybe you drew down the $3 million the first time to get at the float, but you are drawing it down day after day after day. If it is 2-day availability, you draw down the $3 million twice.

Does that, or didn't any of that give you a matter of concern about what you were doing?

Mr. Holland. No, it did not.

Mr. Hughes. Well, just taking back my time, in a number of public statements, E.F. Hutton indicated that if these activities were carried out which led to the guilty plea, they were carried out against company policy, in violation of company policy and procedures.

In effect, the company said that the branch and regional employees that carried out these activities were off the reservation, as my colleagues before indicated, and what you have told us today is that that is not so.

Mr. Holland. That is, absolutely.

Mr. Hughes. So what you have said in essence is Hutton's statement that you were off the reservation is just absolutely incorrect.

Mr. Holland. That is correct.

Mr. Hughes. Well, I must say that I just find it inconceivable that anyone could be participating in this type of a scheme, drawing down those amounts of money, and not be on notice, something is wrong in Denmark.

We are going to recess at this point. Unless my colleagues have any further questions of this witness, why, this witness is excused.

Thank you, Mr. Holland.

The subcommittee stands in recess until 2 o'clock.

[Whereupon, at 1:07 p.m., the subcommittee recessed, to reconvene at 2 p.m., this same day.]

AFTERNOON SESSION 2 P.M.

Mr. Hughes. The Subcommittee on Crime will come to order.

Our next witness this afternoon is Mr. Arthur Jensen. Mr. Jensen is a Regional Operations Manager for E.F. Hutton's Atlantic region. He joined the E.F. Hutton Co. in 1968 and served in various back-office positions until 1980 when he was named regional operations manager.

One of the responsibilities of a regional operations manager, as we understand it, is liaison with E.F. Hutton branch offices in the region.

Mr. Jensen, on behalf of the Subcommittee on Crime, welcome.

Let the record indicate that pursuant to clause 2 of rule XI of the Rules of the House of Representatives, copies of the rules of the Judiciary Committee and clause 2 of rule XI of the Rules of the House are available at the counsel table. You have a right to counsel to assist you in the course of the proceedings.

Are you accompanied by counsel? And, if so, identify him for the record.

TESTIMONY OF ARTHUR JENSEN, REGIONAL OPERATIONS MANAGER, ATLANTIC REGION, E.F. HUTTON

Mr. Jensen. Yes, I am. I am represented by Norman Ostrow on my right, and Lawrence Bader on my left.

Mr. Hughes. I am going to place you under oath now. If you will rise and raise your right hand.

[Witness sworn.]

Mr. Ostrow. We provided the committee, as you know, with a brief personal history of Mr. Jensen, and you summarized that a bit. He is the Atlantic regional operations manager, and I might add he is also from the State of New Jersey.

Mr. Hughes. Well, then he can't be all bad; right?

I did note that, as a matter of fact, in the personal history.

Welcome, Mr. Jensen. Mr. Jensen, one of the practices to which the company pleaded guilty was chaining, or multiple interbranch transfers in the form of having E.F. Hutton branch bank A drawdown by branch bank B, which in turn might be drawn down by branch bank C, then to be drawn down by the regional account, which would then be drawn down by the New York or California national concentration account.

Some of this occurred—quite a bit, in fact—in the Atlantic region in 1981, did it not?

Mr. **Jensen**. Yes.

Mr. **Hughes**. Before getting into specific examples of the chaining, can you tell us what legitimate reasons there might have been for departing from the normal two-step branched region national drawdown account procedure? Can you briefly tell us the legitimate reasons for that?

Mr. **Jensen**. In order to answer that question, I really have to give you a little history of what happened from the time I took over this position in 1980, was promoted to it.

To begin with, when I took over the job as the regional operations manager of the Atlantic region, it was a new position to me and I was not thoroughly knowledgeable in many things that happened in the operations side. Even though I worked for the firm on—in the New York operations for many years, there is a big difference between what happens on the branch retail side and what happens in the main office. And I could compare this to a plant manager for General Motors, to someone who is running one of the biggest car dealerships, front-type office for General Motors.

There were many new things that I had to review. I had to, in my own mind, decide whether things were being handled properly, just like any manager would when he takes over a new position. The cash management portion of my job was actually a minor responsibility.

In my position when I arrived, we had things such as new accounts. We had wired order functions. We had cash clearing. We have a margin department which—for some 300,000 customers I handle—in which we have to protect the firm's finances and make sure that we are not at risk on a daily basis.

We also have administrative functions.

Mr. **Hughes**. I appreciate that, but please answer the question.

Mr. **Jensen**. Let me be brief.

At the same time that I was becoming adjusted to all these other procedures, I was being visited by many bankers who were—I could compare this probably to you gentlemen when you first began reading about this case. The banking portion of our business when you first became involved in it is very detailed, and it is not the easiest thing for the average person to comprehend.

While I had these visits from the bankers, they were beginning to sell certain services to me. They began to talk about remote disbursement accounts and how, by the use of remote disbursement accounts, firms could increase profits due to recapturing or—not only recapturing, but extending float. Terms that the bankers used, as float availability, collected, uncollected, good funds, overdrafts were completely foreign to me at the time.

Mr. **Hughes**. So bankers are explaining to you that this is—can you identify the bankers for us by name?

Mr. **Jensen**. Which banks had visited me to sell services?

Mr. **Hughes**. Yes; to sell that particular service.

If I understand you correctly, you are suggesting that you had banks visit you that were describing to you how you could maximize your interest profits and take advantage of float, which would seem to me to be contrary to the bankers' interests and your interests.

Mr. JENSEN. No. If you look at—I am not a corporate treasurer or in the cash management department. But many—all banks, or large banks, usually have what they call a cash management department today, and that department, the main function is—one of the main functions is to advise the corporation on the use of their funds, whether they are using their funds in a timely manner and are maximizing interest profits.

Mr. HUGHES. Do they advise them to chain?

Mr. JENSEN. No.

Mr. HUGHES. I am trying to find out the reason why you departed from the two-step normal procedure from branch to region to headquarters——

Mr. JENSEN. I just felt that some of the——

Mr. HUGHES [continuing]. To a system whereby we see a device called chaining used, and drawdown on a number of banks, selecting banks where payment was slow, the presentation for payment was slow. And I am trying to find out what legitimate reasons there were for departing from the scheme that was in place, which was a direct branch to region to headquarters. That is my question.

Mr. JENSEN. I am getting to that. I believe part of what I am saying here is that, from my point, I was finding out about float. I was learning. I was hearing things from bankers.

Mr. HUGHES. But I asked you—I am trying to find out the reason. You are giving me a lot of history, and I appreciate that. But I am trying to find out the reason for going from a system that was direct, where you drew down from branch to region to headquarters, to a system that became very diffused throughout the country, to maximize the interest profits by drawing down in particular on banks where it would be presented for payment perhaps 2 or 3 or 4 days, as compared to the presentation the next day of the New York banks.

Mr. JENSEN. Well, in my discussions, the things that I learned from these discussions with various bankers was that the extension of float was something that was known to bankers, to money managers, to corporate treasurers, to the Federal Reserve. And I was led to believe—and I—that there was nothing wrong with the use of float.

Mr. HUGHES. I didn't ask you that. I asked you the reason. I am not asking you whether or not it was approved by the company, company policy. I am asking you, if you know—let me see if you understand the question.

I have asked you the reason for going to the new system. That is what I am trying to find out.

Mr. JENSEN. OK.

Originally, when I took over the position, the branch offices in the Atlantic region when I arrived there were not drawn down by the Atlantic region. The company's policy, or what the company wanted, was that each region take over the responsibility to handle their own drawdowns for the various branch banks under that region's control. When I arrived, all of the branches in the Atlantic region were drawn down by the New York cash desk.

Within a few months—I believe it is a few months—after I arrived, the national cash desk and the national operations wanted me to handle that function. I looked at the function of writing these 50 checks every day, of taking the telephone calls of handling this, and the way I looked at it initially was one of: How can I perform this function in the—in a method where it cost—it would be the easiest for the firm to do at the least expense?

When this function was going to come over from the national, they were not going to give me any additional people who were doing it over there, which they said, "It is a region function; hire whatever staff you need, and put it on your budget."

I said I have a number of branches outside of the Atlantic region—where in the afternoon the cashiers are not that busy, where they could write three checks—and there would be no need to hire any additional personnel to do this.

At the same time, in these branches, one of the things I was concerned about is that I would not want to put any check in a bank where it took them more than 1 day to collect the funds.

Mr. HUGHES. Mr. Jensen, you have effectively utilized my 5 minutes and more and not answered the question. But we will be back—my time has expired—I can assure you.

The gentleman from Ohio.

Mr. FEIGHAN. Thank you, Mr. Chairman.

Mr. Jensen, perhaps you can help me in understanding the role that you played, and some of your colleagues did, in executing some of the cash management practices of E.F. Hutton that have been coming under scrutiny by the Justice Department and ourselves and colleagues in your industry. Perhaps we can focus on some of the concerns that I have as a Representative from Ohio and some of the banks from our State affected.

I understand that in this statement of 2,000 counts of indictment against E.F. Hutton, almost 150 of the counts refer to banks in Ohio, most of which are in my community; and that it was with respect to overdrafts of almost $120 million.

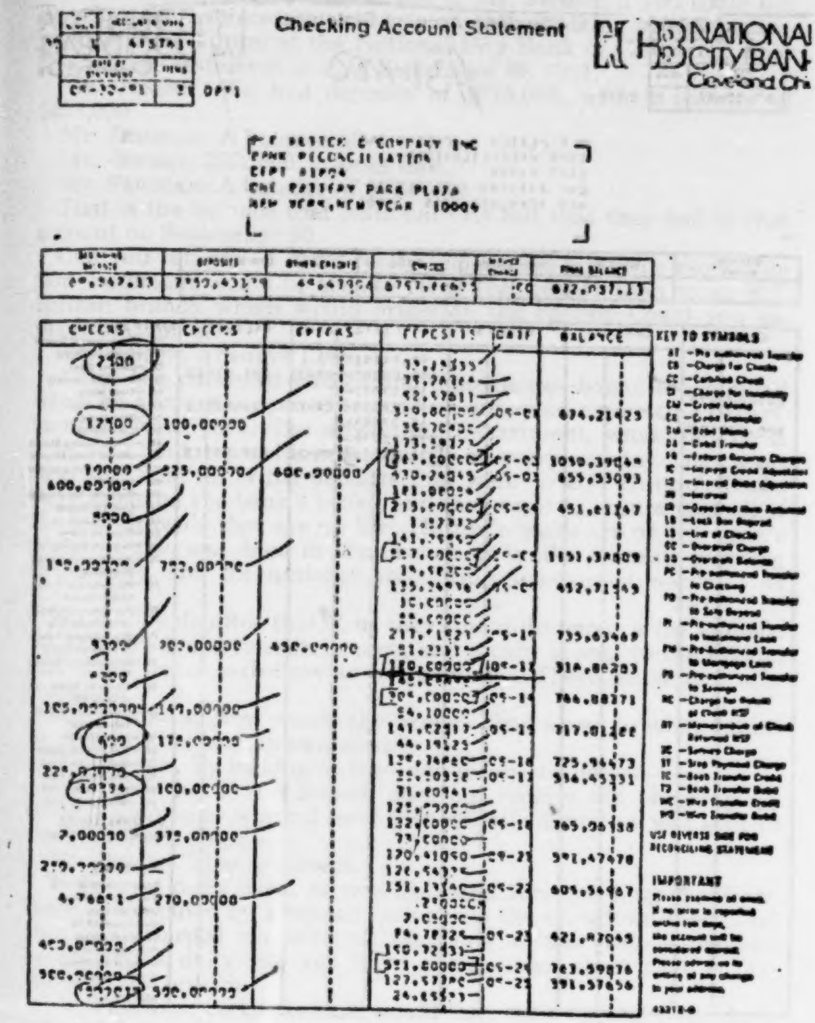
I would like, if I could, to hand you a copy—if someone from the staff would do this for me—I would like to hand you a copy of what——

Mr. HUGHES. Would the gentleman identify the document?

Mr. FEIGHAN. I would like, Mr. Chairman, if I could, to submit for the record a document that is entitled—a "Checking Account Statement" from the National City Bank of Cleveland.

Mr. HUGHES. Without objection, it will be admitted into the record.

[The information follows:]



Checking Account Statement

NATIONAI
CITY BAN
Cleveland Ohi

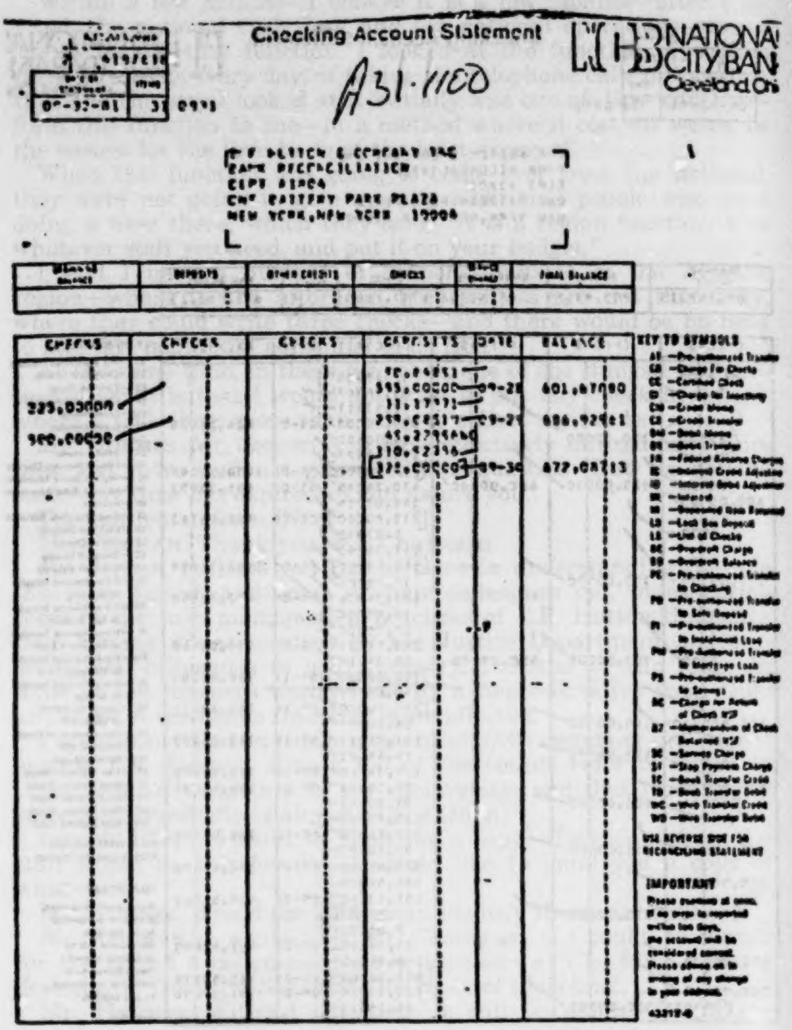
F ... & COMPANY INC
BANK RECONCILIATION
DEPT ...
ONE BATTERY PARK PLAZA
NEW YORK,NEW YORK 10004

CHECKS	CHECKS	CHECKS	DEPOSITS	DATE	BALANCE

KEY TO SYMBOLS
AT —Pre-authorized Transfer
CB —Charge for Checks
CC —Certified Check
CI —Charge for Insufficiency
CM —Credit Memo
CT —Credit Transfer
DM —Debit Memo
DT —Debit Transfer
FR —Federal Reserve Charges
IC —Interest Credit Adjustment
ID —Interest Debit Adjustment
IN —Interest
IR —Deposited Item Returned
LB —Lock Box Deposit
LS —List of Checks
OC —Overdraft Charge
OD —Overdraft Balance
PC —Pre-authorized Transfer to Checking
PD —Pre-authorized Transfer to Safe Deposit
PI —Pre-authorized Transfer to Installment Loan
PM —Pre-authorized Transfer to Mortgage Loan
PS —Pre-authorized Transfer to Savings
RC —Charge for Return of Check NSF
RT —Memorandum of Check Returned NSF
SC —Service Charge
ST —Stop Payment Charge
TC —Book Transfer Credit
TD —Book Transfer Debit
WC —Wire Transfer Credit
WD —Wire Transfer Debit

USE REVERSE SIDE FOR RECONCILING STATEMENT

IMPORTANT
Please examine at once.
If no error is reported
within ten days,
the account will be
considered correct.
Please advise us in
writing of any change
in your address.



Checking Account Statement

NATIONAL CITY BAN
Cleveland Ohi

ACCOUNT NUMBER	419/610
DATE OF STATEMENT	ITEMS
09-30-81	31 0991

A31·1100

E F HUTTON & COMPANY INC
BANK RECONCILIATION
DEPT 41804
ONE BATTERY PARK PLAZA
NEW YORK, NEW YORK 10004

BEGINNING BALANCE	DEPOSITS	OTHER CREDITS	CHECKS	OTHER CHARGES	FINAL BALANCE

CHECKS	CHECKS	CHECKS	DEPOSITS	DATE	BALANCE
			90,04851		
			395,00000	09-28	601,67090
223,03000			11,17771		
			299,08517	09-29	686,92981
900,00000			45,27996		
			110,92396		
			375,00000	09-30	677,08713

KEY TO SYMBOLS
AT —Pre-authorized Transfer
CB —Charge for Checks
CC —Certified Check
CI —Charge for Imprinting
CM —Credit Memo
CT —Credit Transfer
DM —Debit Memo
DT —Debit Transfer
FR —Federal Reserve Charge
IC —Interest Credit Adjustment
ID —Interest Debit Adjustment
IN —Interest
IR —Deposited Item Returned
LD —Lock Box Deposit
LS —List of Checks
OC —Overdraft Charge
OD —Overdraft Balance
PC —Pre-authorized Transfer to Checking
PD —Pre-authorized Transfer to Safe Deposit
PI —Pre-authorized Transfer to Installment Loan
PM —Pre-Authorized Transfer to Mortgage Loan
PS —Pre-authorized Transfer to Savings
RC —Charge for Return of Check NSF
RT —Memorandum of Check Returned NSF
SC —Service Charge
ST —Stop Payment Charge
TC —Book Transfer Credit
TD —Book Transfer Debit
WC —Wire Transfer Credit
WD —Wire Transfer Debit

USE REVERSE SIDE FOR RECONCILING STATEMENT

IMPORTANT
Please examine at once. If no error is reported within ten days, the account will be considered correct. Please advise us in writing of any change in your address.

432174

Mr. **Feighan**. I would appreciate it, Mr. Jensen, if you could tell us what the balance statement is on this checking account statement of E.F. Hutton at the National City Bank of Cleveland, what the balance statement is as of September 30, 1981.

Mr. **Jensen**. We had deposits of $325,000, with a balance of $677,000.

Mr. **Feighan**. A balance of——

Mr. **Jensen**. $672,000, it looks like.

Mr. **Feighan**. A balance of $672,000.

That is the balance that National City felt that they had in that account on September 30.

Can you tell me—I don't really understand why this reconciliation statement would be sent to New York rather than to an E.F. Hutton branch which would originate the checks. Could you explain that for us?

Mr. **Jensen**. I believe I can.

All of the cancelled checks and statements—banks are notified when an account is opened to send on our main accounting department in New York. The accounting department, what they do is they do a bank reconciliation monthly on every account. They want to ensure that all of the deposits that were on E.F. Hutton's books were made on the bank's books, and they want to ensure that all of the withdrawals that are on E.F. Hutton's books are on the bank's books. If this was done in the branch, it is like someone auditing themselves, and the national accounting department wants to do the audit.

What they do after this is, as they find differences, a list is made up and forwarded to each branch, and a copy is sent to the region, and these items each have to be reconciled. There could be a mistake——

Mr. **Feighan**. How would the branch then know to what extent its account had been drawn down?

Mr. **Jensen**. By looking at the—you mean—could you——

Mr. **Feighan**. If the branch does not receive the checking account statements, which I have just identified, and as was sent to the New York office——

Mr. **Jensen**. That is correct.

Well, on a daily basis, as was discussed this morning, the drawdown is computed by a branch cashier via the drawdown sheet, and that is forwarded via wire or telephone to the various regional headquarters daily. So, you have a drawdown sheet that is prepared in the branch——

Mr. **Feighan**. So the branch would have on a regular basis daily information on the status of that account if there were drawdowns against it?

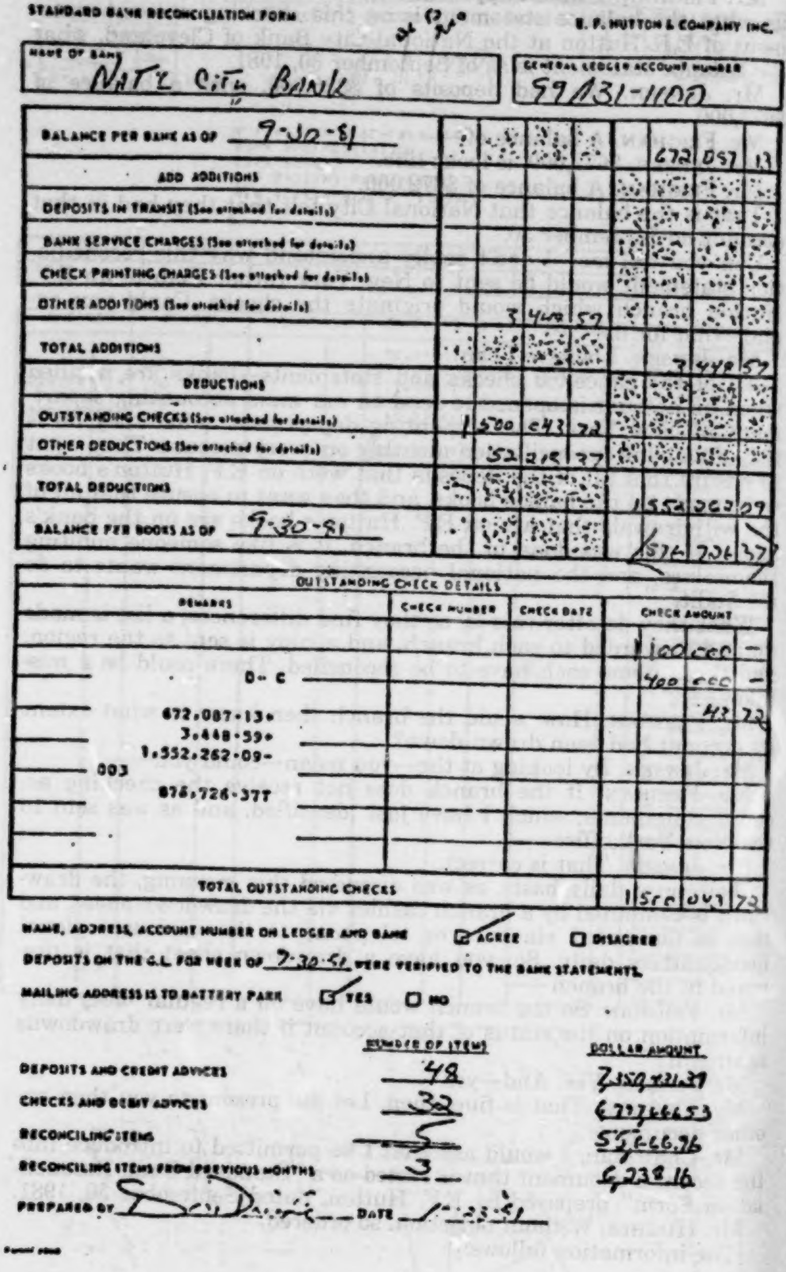
Mr. **Jensen**. Yes. And—yes.

Mr. **Feighan**. That is fine, then. Let me present to you then another document.

Mr. Chairman, I would ask that I be permitted to introduce into the record a document that is stated as a "Standard Bank Reconciliation Form" prepared by E.F. Hutton, dated September 30, 1981.

Mr. **Hughes**. Without objection, so ordered.

[The information follows:]



STANDARD BANK RECONCILIATION FORM

E. F. HUTTON & COMPANY INC.

NAME OF BANK: NAT'L City Bank	GENERAL LEDGER ACCOUNT NUMBER: 99131-1100

BALANCE PER BANK AS OF 9-30-81		672 057 13
ADD ADDITIONS		
DEPOSITS IN TRANSIT (See attached for details)		
BANK SERVICE CHARGES (See attached for details)		
CHECK PRINTING CHARGES (See attached for details)		
OTHER ADDITIONS (See attached for details)	3 448 57	
TOTAL ADDITIONS		3 448 57
DEDUCTIONS		
OUTSTANDING CHECKS (See attached for details)	1 500 043 72	
OTHER DEDUCTIONS (See attached for details)	52 218 37	
TOTAL DEDUCTIONS		1 552 262 09
BALANCE PER BOOKS AS OF 9-30-81		(876 726 37)

OUTSTANDING CHECK DETAILS

REMARKS	CHECK NUMBER	CHECK DATE	CHECK AMOUNT
			1 100 000 –
0– C			400 000 –
672,087.13+			43 72
3,448.59+			
1,552,262.09–			
003			
876,726.37T			
TOTAL OUTSTANDING CHECKS			1 500 043 72

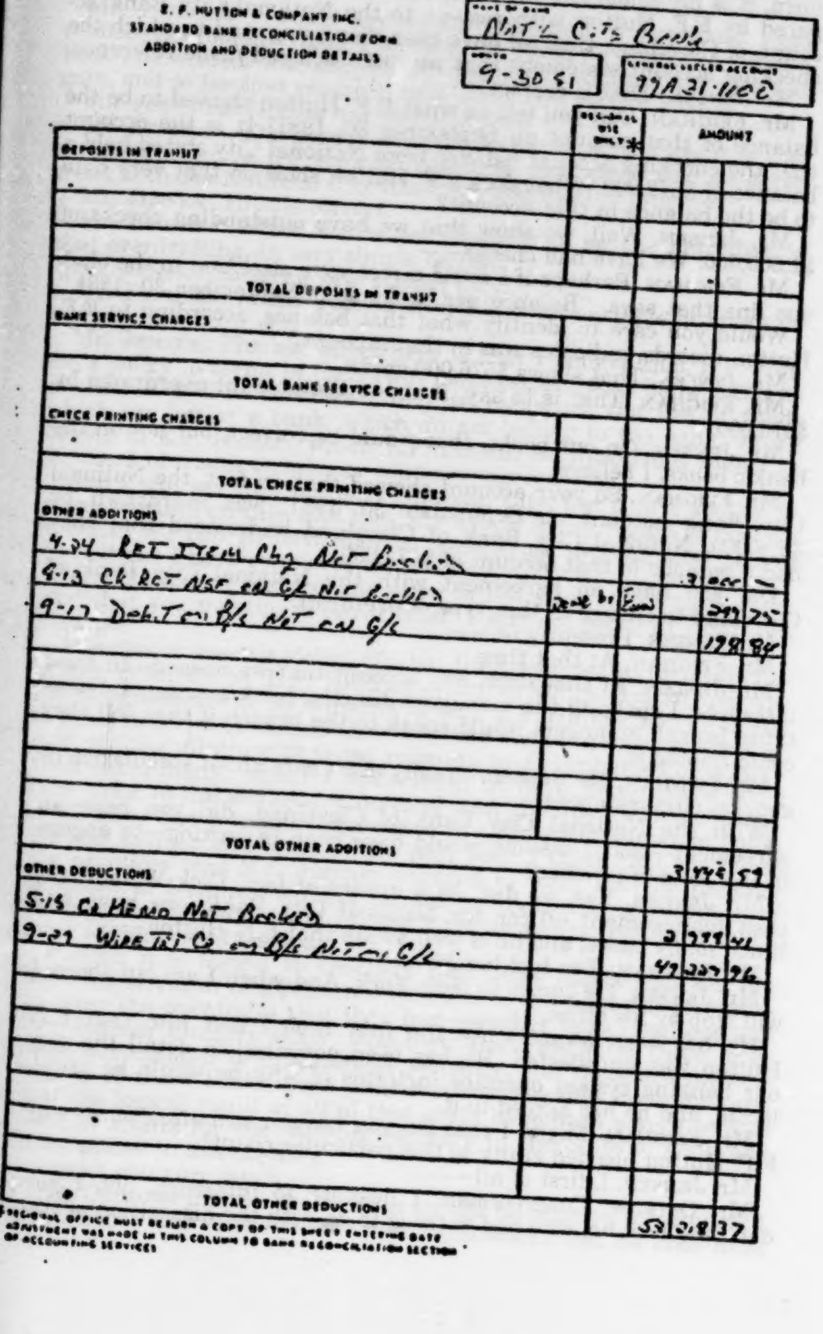
NAME, ADDRESS, ACCOUNT NUMBER ON LEDGER AND BANK ☑ AGREE ☐ DISAGREE

DEPOSITS ON THE G.L. FOR WEEK OF 9-30-81 WERE VERIFIED TO THE BANK STATEMENTS.

MAILING ADDRESS IS TO BATTERY PARK ☑ YES ☐ NO

	NUMBER OF ITEMS	DOLLAR AMOUNT
DEPOSITS AND CREDIT ADVICES	48	7,359,431.39
CHECKS AND DEBIT ADVICES	32	6,772,666.53
RECONCILING ITEMS	5	556,066.96
RECONCILING ITEMS FROM PREVIOUS MONTHS	3	6,238.16

PREPARED BY D. Davis DATE 10-23-81



E. F. HUTTON & COMPANY INC.
STANDARD BANK RECONCILIATION FORM
ADDITION AND DEDUCTION DETAILS

NAME OF BANK: Nat'l City Bank

MONTH: 9-30-81

GENERAL LEDGER ACCOUNT: 77A21·110C

	REGIONAL USE ONLY*	AMOUNT
DEPOSITS IN TRANSIT		
TOTAL DEPOSITS IN TRANSIT		
BANK SERVICE CHARGES		
TOTAL BANK SERVICE CHARGES		
CHECK PRINTING CHARGES		
TOTAL CHECK PRINTING CHARGES		
OTHER ADDITIONS		
4-24 RET ITEM Chg Not Booked		
9-13 Ck RET NSF on G/L Not Booked		3 000 —
9-17 Deb. Tran B/S Not on G/L	Done by [illegible]	299 75
		178 84
TOTAL OTHER ADDITIONS		3 445 59
OTHER DEDUCTIONS		
5-15 Cr Memo Not Booked		
9-27 Wire Trf Cr on B/S Not on G/L		2 799 41
		49 327 96
TOTAL OTHER DEDUCTIONS		52 127 37

*REGIONAL OFFICE MUST RETURN A COPY OF THIS SHEET ENTERING DATE ADJUSTMENT WAS MADE IN THIS COLUMN TO BANK RECONCILIATION SECTION OF ACCOUNTING SERVICES

Mr. **Feighan**. Mr. Jensen, if you would review that reconciliation form, it is my understanding that this is a reconciliation form prepared by E.F. Hutton with respect to the National City Bank account, of Cleveland, that we have been discussing, and to which the checking account statement that we just discussed made reference.

Mr. **Jensen**. That is correct.

Mr. **Feighan**. Can you tell us what E.F. Hutton showed to be the balance of that account on September 30, 1981? It is the account that the checking account balance from National City stated held a balance of $672,000. What does E.F. Hutton show on that very date to be the balance in that account?

Mr. **Jensen**. Well, we show that we have outstanding checks of $1,500,000. We have had checks——

Mr. **Feighan**. Perhaps if I could direct your attention to the obvious line that says, "Balance per books as of September 30, 1981."

Would you care to identify what that balance, according to E.F. Hutton records, indicates was in that account?

Mr. **Jensen**. That shows $576,000 credit.

Mr. **Feighan**. That is to say, it shows the account overdrawn by $576,000.

Mr. **Jensen**. On our books, that would be correct; but not on the bank's books, I believe.

Mr. **Feighan**. So your account showed that, in fact, the National City Bank account on September 30, 1981, was overdrawn by $576,000. National City Bank of Cleveland understood that they had a balance in that account of $672,000.

Did you have an agreement with the National City Bank of Cleveland to engage in that type of overdraft?

Mr. **Jensen**. Presently or——

Mr. **Feighan**. At that time.

Mr. **Jensen**. At that time, any account that we opened—in some instances, I spoke to the managers directly, bank managers. Sometimes branch managers would speak to the branch if they felt they could handle it.

Mr. **Feighan**. Mr. Jensen, I really don't care about speculation or general circumstances.

With the National City Bank of Cleveland, did you have an agreement—that I assume would have been in writing—to engage in this kind of practice?

Mr. **Jensen**. Yes, we did. As a matter of fact, Dick Weiner, the cash management officer for National City Bank—we have had lunch many times, and he is well aware that E.F. Hutton——

Mr. **Feighan**. You had lunch?

Mr. **Jensen**. He comes to New York. And when I am out there, I will stop by his office.

He has been aware since the first time I met him that E.F. Hutton was uncollected. He has been described in detail the way our banking system operates in terms of why he would be uncollected, and he has agreed to it.

Mr. **Feighan**. Might I ask: Do you have information as to why E.F. Hutton pleaded guilty to this particular count?

Mr. **Jensen**. I, first of all——

Mr. **Ostrow**. Congressman, I hesitate to interrupt, but I just don't see how he, who had nothing to do with the disposition of this case, can answer what was in the minds of people who disposed of it.

Mr. **Hughes**. I would say to my colleague, if he would yield, counsel is probably right. I am sure it would be just pure speculation. The witness was not privy to any negotiations or the plea bargain, and so for that reason I don't know how he can answer.

The gentleman's time has about expired.

Mr. **Feighan**. The point I was to underscore is, you say it is your understanding, as the regional manager, that there was an agreement with the National City Bank for that kind of practice?

Mr. **Jensen**. That is correct.

Mr. **Feighan**. What would you describe to be the net effect of that overdrafting, in very simple terms?

Mr. **Jensen**. In terms of National City?

Mr. **Feighan**. In this regard. But this is an example of many instances.

Mr. **Jensen**. The net effect here is that I believe that E.F. Hutton's policy in terms of their cash management with bank accounts is that it is E.F. Hutton's policy to recapture the use of funds which are left at a bank, which do not belong to the bank, which belong to E.F. Hutton, which E.F. Hutton received from clients in payment of trades or sales or contracts agreed with.

And I will say that not only National City, but I have spoken to many bankers on this, and they are aware in my region of how we operate. We can go next door to Ameritrust in your city, and in Ameritrust I have gone over this.

Mr. **Feighan**. I am growing close to the close of my time. I am glad that you mentioned Ameritrust. I was not going to raise that example.

Ameritrust was the victim of what they regarded as certainly improper practices by E.F. Hutton, practices which Ameritrust was not in agreement to. As a matter of fact, E.F. Hutton acknowledged to Ameritrust of Cleveland that they had been improper in the conduct of their affairs with those accounts, and reimbursed by Ameritrust accordingly, which I understood to have taken place some time prior to the settlement reached with the Justice Department.

We have had a unique experience in Ohio with respect to banking and savings and loans in the past year. I think that the banking practices that E.F. Hutton engaged in were not the banking practices of businessmen but similar to the banking practices of cowboys, who would come in and hold up banks, but in a much more sophisticated fashion.

I think it is logical to conclude that those banks that did not have the strength of a National City Bank, the financial resources to cover the overdrafts that they had—smaller banks perhaps like the Genesee Country Bank, who blew the whistle on those practices, were placed in considerable jeopardy, and therefore the customers of those banks were placed in considerable jeopardy—and that the logical result of all of that could have been a very serious state of affairs for the banking industry in the State of Ohio and other places in this country.

Thank you very much.

Mr. **Ostrow**. I think the witness should be allowed to respond. I don't know who is the best expert on cowboys, but he does have something from the newspaper that is right on point, and perhaps we could mark it or have him read from it.

Mr. **Hughes**. The witness can respond.

Mr. **Jensen**. Thank you.

I have an article here. And I have had dealings with Ameritrust for quite a while. This was printed in a Ohio newspaper, and it is a quote from the Plain Dealer from an officer of Ameritrust.

"Preliminary analysis says we are very wholeworthy of Hutton. We continue to enjoy a very fruitful relationship with them."

He also goes on and states, "All large corporations play the float very aggressively. I don't think there is anything unethical in playing that float."—Donald Broomfield, Ameritrust.

After, there were some articles printed in the Cleveland papers which Ameritrust called me on, and they were very upset because they claimed they never said anything to the effect that E.F. Hutton owed them any money or that there was anything improper with our relationship or the way our contracts were handled.

Mr. **Hughes**. What is the date of the article?

Mr. **Jensen**. It is not on the copy here, but let me see if I have another one with me that maybe wasn't cut off.

Mr. **Feighan**. Mr. Chairman, if I might——

Mr. **Hughes**. The gentleman might want to identify the banker making the statement and the date.

Mr. **Ostrow**. We will see if we can provide you with the date. We just have a staff writer name, Mike Mahoney, who did the piece.

Mr. **Feighan**. Mr. Chairman, I hope we have occasion to have a representative from Ameritrust before us so we can clear that point up, because at the date of that article—in fact, it is my understanding that Ameritrust was made whole by the practices of Hutton but they were made whole only because Ameritrust had discovered the improper, unethical, what someone described as illegal practices that E.F. Hutton had engaged in, and after those complaints E.F. Hutton made restitution. After that, the statements in the article as to having been made whole would be accurate.

I would also suggest that none of us is naive enough to believe that Ameritrust or the other banks that E.F. Hutton has been dealing with do not want to lose those valuable accounts, and that might in part attribute some of their enthusiasm.

Mr. **Hughes**. The gentleman's time has expired.

The gentleman from Florida is recognized for 5 minutes.

We are going to stay with the 5-minute rule. We want to hear from the witnesses, but I hope that members can restrict their questions to about 5 minutes.

Mr. **McCollum**. Mr. Jensen, this morning, or early this afternoon—I have forgotten which—Mr. Holland was testifying about the Wilkes-Barre branch. He indicated he did know you; that on one occasion he recalls that you telephoned him and that was the occasion on which he first got a directive to start drawing on some of these banks in New York that the Wilkes-Barre sub-branch drew upon.

Do you recall talking with him and giving him such directions?

Mr. **Jensen**. Yes, I do.

Mr. **McCollum**. Was this the beginning of a process that was fairly new for you, or was this somewhere in the mainstream of what you were describing earlier as the process of getting the branches to draw down on one another? In other words, was this sort of the beginning of the whole thing, or was this somewhere in the middle?

Mr. **Jensen**. I would believe it was—I would have to say toward the beginning, yes.

Mr. **McCollum**. All right. When you made the telephone call, what prompted that call? Do you have any recollection? Was that something because of policy decisions that had come down from New York, or was this something that originated with you personally or something somebody advised you, or your staff, to do?

Mr. **Jensen**. There were a number of reasons, one of which I was attempting to discuss before, and one is that I was trying to disperse a function at no labor cost and produce a product at the lowest cost possible.

There was also—I had seen what we would call a miniconcentration account set up at E.F. Hutton previously. I did not feel that there was anything wrong with this, or unethical. I felt to save money, possibly even to—I wasn't sure what was going to happen with, say, the extension of float, which I have had talks with bankers and people on it, and it was something to look at. I didn't think there was anything wrong with that, also.

So I will say that prompted it.

Mr. **McCollum**. Well, Mr. Jensen, let me describe this situation as I see it in just the example of Mr. Holland's drawing on those banks in New York after he got the word from you to do that.

As he drew on those banks, was the purpose of drawing on those banks because—what was the purpose of drawing on those banks? Let me ask you that question. You said that you didn't have the manpower to take care of all this yourself; that is one thing. But what was the bottom line reason why those banks were being drawn on, the objective?

Mr. **Jensen**. Two objectives: One, to produce a product at the lowest cost; the other objective, as I mentioned, was I felt that there was nothing wrong—as I had been taught, I would say, from looking at things the firm was doing and talking to bankers throughout the region—with the extension of float.

Mr. **Hughes**. Would the gentleman yield?

The gentleman has not answered the question. He didn't ask you whether or not it was legitimate, whether you felt it was proper. He asked you specifically the reason. Now, you haven't answered the question.

I also want to counsel counsel at the table. The witness can answer the questions. If counsel wants to advise the witness insofar as the legal ramifications of answers, he might do so. But the witness is the witness and we will hear from the witness.

Answer the question. He asked you the reason for doing it. Why were the three accounts set up in Pennsylvania, the reason?

Mr. **Jensen**. The reason was, first, to—as I had mentioned, and I thought this is a reason—maybe I am not thinking it through clearly, but one reason was to produce a product at the lowest cost. The second reason was possibly there will be an extension of float, but I didn't feel this was wrong.

Mr. McCOLLUM. You wanted an extension of float. That was one of the reasons to do it.

Is that correct?

Mr. JENSEN. A possibility. In looking at this, a lot of things that happened earlier—when bankers come in and you start talking about availability and availability schedules, your bank offers 1 day and the man down the street—if you look at his schedule, you talk to him, and it is 2 days. Why is his 1 day; another guy's 2 days?

Mr. McCOLLUM. Let me get back to the extension of float business. Extension of float means different things to different people.

What I gather you mean by that, and what was happening is that there is a profit to the bank for a period of time for carrying a person's money without having to pay interest to the account holder or, in the case of E.F. Hutton, it is a chance to extend the float period so that you have a longer period of collectability, a longer time between collections, so you recoup some of what otherwise would be a bank profit on money sitting there but not paid to a customer in interest for a period of time.

Is that the same thing? You get lost in these great technicalities.

I am on the Banking Committee, as well, so I am not trying to trick you. I want to get a layman's description of this, because we talk in terminology that most people don't understand.

Mr. JENSEN. Now you know what I went through when I first started in this position. We are in similar circumstances.

Let's talk in the easiest way to me of an extension of float. The first example I could give you when I heard of it was on a remote disbursement account where you open an account with a bank, and instead of clearing your collections here in Washington, DC, that bank can clear it in Alexandria or somewhere else that is a little more remote. And there is only one drop per day from the Federal Reserve in terms of a check getting there.

So someone from the Federal Reserve will come in three times a day presenting checks to the bank for collection, and since there is less chance of checks coming in, there will be more of a chance for float to occur.

Mr. McCOLLUM. And the more float that occurs in this case from the point of E.F. Hutton's ability to control it, the more interest will be captured by E.F. Hutton in its accounts instead of the bank capturing that interest; is that correct?

Of course, that 1-day availability exists between the banking institutions that you had arrangements with.

Mr. JENSEN. The 1-day availability is something that E.F. Hutton always asked bankers if we wanted either zero on cash checks drawn on your bank or Federal funds, and 1 day on a majority of the other deposits. It wasn't normal for us to deposit a check from Wyoming, as we spoke this morning. It would be normal, let's say, in Harrisburg to deposit a New York City check because we did it three times a week, whenever we needed a reimbursement check. So, the normal flow on a check would be 1 day.

Mr. McCOLLUM. I know my time is about up, but I want to ask you this: We heard early on today—Mr. Sullivan testified about prior times when he set up a procedure for the overdrafting policies that he thought would recapture certain concerned losses that might otherwise take place in cash value, and he had a specific work sheet.

We have heard from Mr. Holland today, and from your testimony—we know from outside sources where we have investigated this that that procedure was expanded upon either by direction or by other interpretations of that within the E.F. Hutton process, so it wasn't quite that straight a thing.

My implication from all of this is that, in fact, what many in the field, many maybe in your position, felt was that one of the objectives in all of this was to do what you could to maximize within reason the time period of the checks so that they passed through different banks on their way to the home office over a period of 2 or 3 days. That would delay their collection, extend the float. That would give the opportunity for E.F. Hutton to maximize the amount of interest that it was going to earn, if you will, and not have to pay out. That is as simple as I can put it without getting too technical.

Is that correct?

Mr. **Jensen**. That is part of the answer, yes.

Mr. **McCollum**. That is one of the objectives that you had. Thank you. I yield back, Mr. Chairman.

Mr. **Hughes**. The gentleman from West Virginia is recognized for 5 minutes.

Mr. **Staggers**. I yield my time to the Chair.

Mr. **Hughes**. I thank the gentleman.

I just want to follow up for just 1 minute. We have two principles we seem to be confusing. One is availability and the other is clearance.

It is in E.F. Hutton's interest, is it not, to have immediate availability and to have a check clear in 5 days, lengthening the time of clearance; isn't that in E.F. Hutton's interest?

Mr. **Jensen**. It is in E.F. Hutton's interest to get immediate availability, yes.

Mr. **Hughes**. How about delaying clearance?

Mr. **Jensen**. There is no way you can control that.

Mr. **Hughes**. Isn't that what the purpose of chaining is? Come on, now, Mr. Jensen——

Mr. **Jensen**. As I said earlier——

Mr. **Hughes**. You know, isn't it a fact that the reason you went through lengthy complex chains was to delay the clearance of checks, the time that they are presented for payment? And isn't that the reason why you had three banks in New York in close proximity to Wall Street that cleared almost immediately, all of a sudden being drawn down out of Pennsylvania, and a bank that clears very slowly in Wilkes-Barre? Isn't that so?

Mr. **Jensen**. As I stated, initially the first idea was no—that was part of it, yes, but not the whole answer.

Mr. **Hughes**. I don't find your testimony very forthright. I think you can answer the questions. I think you understand the questions and you have taken us round robin now on a lot of these.

The fact of the matter is that you ordered Mr. Holland to start drawing down the New York banks because you determined that Wilkes-Barre was clearing very slowly.

Isn't that so?

Mr. Jensen. That is not true.

Mr. Hughes. What was the reason? Why would you take three accounts in New York where you have immediate availability?

Mr. Jensen. When the three accounts went into Wilkes-Barre, I didn't know what the clearance would be there. As a matter of fact, putting three New York banks there I believed it would probably be a 1-day clearance because Wilkes-Barre was already getting replenishment checks a number of times a week, and if there were problems it would have showed up on their bank analysis.

Mr. Hughes. You mean to tell me you couldn't get 1-day clearance in New York?

Mr. Jensen. We could.

Mr. Hughes. What you are telling us is that you can get better clearance by moving these accounts and having them drawn down in Wilkes-Barre? That is not logical. You have got the biggest monster of the world in New York.

Are you suggesting to us you can get better availability in Wilkes-Barre, PA?

Mr. Jensen. I am not suggesting that.

Mr. Hughes. Well, the gentleman from Connecticut is recognized for 5 minutes.

I wonder if the gentleman from Ohio will take the chair for a few minutes.

I wonder if the gentleman from Connecticut will begin to put into evidence for us about five different memorandums and documents, and I will ask him if he would pursue that.

Mr. Morrison. I will be happy to, Mr. Chairman.

Mr. Chairman, if I might begin by asking for unanimous consent that the March 26, 1982 memo from Mercedes E. Neff be entered into evidence at this point, and that the staff would share a copy of that document with Mr. Jensen.

Mr. Feighan [presiding]. Without objection, so ordered.

[The information follows:]

[illegible]
INTER-OFFICE MEMORANDUM

FROM Mercedes E. Neff

DATE March 26, 1982

SUBJECT New York Lock Box Account

Attached is the information I promised you on your lock box account.

As you can see, the account analyses show negative collected balances for the 7 month period ending January, 1982. (August statement was not available). One reason the account is constantly uncollected relates to the substantial amount of one and 2 day float on our deposits. I am currently working with our representative in Bankers Trust on this problem, and I hope to have it resolved in the near future. I will keep you informed of any new developments.

Art, as I mentioned to you earlier this month, it is a combination of poor availability and the $1,000,000 overdraft procedure which causes problems with this account. As of March 23rd, per Tom Morley's instructions, this one million dollar "deposit adjustment" has been eliminated. Hopefully, this will help alleviate some of the problems.

I have arranged to have someone from Bankers call Hugh every morning with the deposit totals. I am not sure this step is really necessary since we receive the deposit tickets (and copies of the checks) the same day the deposit is made. In addition, the phone call from Bankers will only include the early morning deposit and not the noon and 2:30pm deposits. However, the early morning deposit appears to be the only one where we receive same day (immediate) funds as well as the two day float. Until this problem is resolved, I think it would be to our advantage to keep track of the availability assigned to this deposit.

For the time being, the total of our deposits on any given day should be the draw down figure of that day. At some future point in time we will "fine-tune" this procedure to take advantage of immediately available funds, but for now no adjustments should be made.

Please contact me if you have any questions.

Mercedes E. Neff

cc: Tom Morley
Kevin Mahoney ✓

Mr. **Morrison**. Thank you.

Have you had a chance to look at that document?

Mr. **Jensen**. Yes.

Mr. **Morrison**. First of all, the copy that we have doesn't have an addressee, but the body of the memo refers to "Art," and it refers to the New York lock box account. That leads us to believe that the "Art" in question is Art Jensen.

Is that accurate?

Mr. **Jensen**. I don't remember the memo per se, but I do remember facts about this situation.

Mr. **Morrison**. So, this is a subject with which you are familiar?

Mr. **Jensen**. Yes.

Mr. **Morrison**. Now, if you look at the third paragraph, it says: "Art, as I mentioned to you earlier this month, it is a combination of poor availability and the $1 million overdraft procedure which causes problems with this account."

What was the $1 million overdraft procedure?

Mr. **Jensen**. Well, the $1 million overdraft procedure actually was in effect before I took the responsibility of the position of Atlantic region operations manager. And from what I have been told, since I wasn't here when this lock box was opened—but it was opened—it might have been by Tom Morley or Bill Sullivan—and from what I have been told and what I have heard, is that when it was initially opened, that there was again processing work that had to be done in the operation of a lock box, and there was an agreement made between either Tom Morley or Bill Sullivan, whoever set up this lock box—that they were so enthused about this lock box that they told the person—my predecessor, I presume, Joe Carney—that if he will arrange for this lock box and do the processing of it, that they will pay the service charge.

Well, they would pay a $1 million—they would allow a $1 million over——

Mr. **Morrison**. Who is the "they" that we are talking about here?

Mr. **Jensen**. Here again, I wasn't there when it was initiated. But I presume it would have to be either Bill Sullivan or Tom Morley; probably Bill Sullivan.

Anyway, they were saying that, OK, the Atlantic region can withdraw an extra million dollars from this account to pay for all of the processing. What they had in mind was that this account with Bankers Trust—E.F. Hutton had other accounts with Bankers Trust, so in effect they were going to leave more money in other accounts to compensate for this $1 million.

Mr. **Morrison**. How do you know that they were leaving money in other accounts to cover this $1 million? They weren't leaving money in other accounts to cover the millions that were being written all over the country.

Do you know for a fact that they were leaving compensating balances, or are you just speculating?

Mr. **Jensen**. I was told that.

Mr. **Morrison**. By whom were you told that?

Mr. **Jensen**. I was told—I was told that was the way that this account was supposed to run.

Mr. **Morrison**. When were you told that?

Mr. **Jensen**. Probably in 1982.

Mr. **Morrison**. You seem to remember—the only thing you seem to remember is the justification for a $1 million overdraft procedure; that it was handled by compensating balances. You don't know when—you don't really know how this was set up. It seems very convenient that you remember the explanation but none of the surrounding details. You don't know who said what to whom, except you were told it was compensating balances. That doesn't square with your lack——

Mr. **Jensen**. I wasn't there.

Mr. **Morrison**. So you really don't know if there were compensating balances?

Mr. **Jensen**. I was told that.

Mr. **Morrison**. But you don't know.

Mr. **Ostrow**. On the one hand, you ask specific questions——

Mr. **Morrison**. Was your name entered into the record?

Mr. **Ostrow**. I think you weren't in the room when we first convened, so perhaps that is why you missed that.

I am also a little disappointed that the chairman——

Mr. **Feighan**. If the gentleman would allow the chairman to interrupt, you may respond to the question that is posed by the gentleman from Connecticut.

Mr. **Ostrow**. The chairman, before he left, said——

Mr. **Feighan**. Or you may advise your client.

Mr. **Ostrow** [continuing]. The chairman, before he left, said some things about my client, and then leaves and doesn't hear the rest of his testimony.

I am here for legal purposes. I have been admonished.

Mr. **Feighan**. Let me admonish you. I am the chairman of this hearing at this time. You may advise your client or you may respond to the gentleman from Connecticut.

Mr. **Ostrow**. That is what we were trying to do before I was interrupted. When you ask a specific question, we will try to give a specific answer.

Most respectfully, some of the questions elicit the sort of answer that is speculative. I don't know how a witness can deal with that.

Mr. **Morrison**. I think we are capable up here of dealing with what we are hearing.

Why don't we just go through this very carefully because I think it goes to the questions of what else we should think about what we are being told by this witness.

Back to the document, the $1 million is an overdraft procedure; is that correct? Is that what you are telling me?

Mr. **Jensen**. What was approved by our cash management department.

Mr. **Morrison**. So someone like Tom Morley or Bill Sullivan, as best you know, told your predecessor in the New York region that they could overdraft a certain account a million dollars, and you believe that was in compensation for the management of this lock box.

Is that basically what you have said?

Mr. **Jensen**. I was told that it was compensation for that lock box.

Mr. Morrison. And beyond that, it was not your responsibility and you don't really know what was done with respect to Bankers Trust, you didn't have dealings with Bankers Trust on this?

Mr. Jensen. Hutton had many dealings and that was really the cash management department.

Mr. Morrison. So you didn't really deal with whether Bankers Trust was compensated fairly or not, or whether they understood there would be million dollar overdrafts; is that fair?

Mr. Jensen. That is fair to say yes. You would have to question them on that.

Mr. Morrison. But you know, this was an approval by the cash management people to overdraft a million dollars?

Mr. Jensen. That is correct.

Mr. Morrison. On a particular account?

Mr. Jensen. That is correct.

Mr. Morrison. Let me ask, Mr. Chairman, if we could introduce another document which is the June 18, 1985, memo from Richie Lee to the Atlantic region cashiers. It is a somewhat difficult-to-read document, and there is a copy of which has been prepared, if both could be entered in the record.

Mr. Feighan. Without objection they will be part of the record.

[The documents referred to follow:]

EF Hutton
INTER-OFFICE MEMORANDUM

TO Atlantic Region Cashiers
FROM James Kelly
DATE June 2, 1981
SUBJECT Reminders from Seminar

Below is a list of reminders from our recent Cashiers Seminar.

1.a) Do not hold securities in the branch if waiting for Legal papers.

Ship all securities to N.Y. the day they are received from clients.

b) Do not send Legal papers to N.Y. unless N.Y. has a Legal full paid security.

c) Use new Legal Security Unit Form 2636, dispose of old Forms 2636. Revised Form 2636 Legal Full Paid must include only one security for each form.

d) Follow up with A/E's for Legal item pending papers every Monday.

2. Follow up with A/E's for securities which need stock powers from Stock Power Listing.

3. Obtain a letter signed by the customer to swap coupon bonds to registered.

4. Make deposits to bank daily up to ½ hour of closing.

5. Run two tapes for checks received. One tape from blotter and one from actual checks received.

6. Utilize Express Mail (U.S. Post Office) if available when shipping Bearer Bonds to N.Y. You may ship up to $3,000,000 per package, per day. Report total shipments seperate from 1st class and registered to Legal and Compliance yearly.

7. A letter of authorization from the client must be obtained when changing Joint name stock to an individual.

8. Follow-up on all letters sent to client form 3065 when an A/E hand delivers a check on security to a client.

9. Lock up everything in Cashiers area before leaving each night.

10. Correct Bank Reconciliation differences immediately upon receipt of Bank Reconciliation from Hugh van Hengel. This is extremely important, it must be done!

11. Drawdown as discussed. You may drawdown more than formula but not less! This will depend on individual Branch/Bank circumstances.

James Kelly
James Kelly

JK:ac

cc: Art Jensen
Hugh van Hengel ✓

Mr. **Morrison**. And if Mr. Jensen could be permitted to review it.

Are you familiar with this?

Mr. **Jensen**. Yes, I am.

Mr. **Morrison**. Now, you received a copy of this memo and have you been implementing the proposal in your region with respect to what this memo covers?

Mr. **Jensen**. Yes, we have.

Mr. **Morrison**. And what kind of reactions are you getting from the banks and what kind of understandings is—are the banks signing these documents and sending them back to you?

Mr. **Jensen**. Well, you have two—you have two different things here. First of all, Richie Lee's memo has nothing to do with really the bank consent. Richie Lee's memo somewhere in the beginning of June, the firm decided to alter the drawdown sheet that we have been using and they wanted to alter it to become even more—what can I say—well, lenient. This, in effect, puts us in a position where we are leaving more funds with banks. We have more collected deposits.

If you look at bank analysis after this, many bankers are very happy right now. They are making a lot of money.

Mr. **Morrison**. We have been told in the past that the assumption of the present system is 1-day availability, you draw down today what you are confident will be available tomorrow. Do you understand that to be the way you are operating?

Mr. **Jensen**. Yes; from the beginning the company policy was that we would ask each bank that we would need zero or 1-day money. When we have 1-day money, that means if it was deposited today in the bank and we drew on it in New York today, they would both be collected tomorrow.

Now, this sheet here was put in effect at the same time, or approximately I guess, when the standard bank consent was sent to all of the banks that we are dealing with in the Atlantic region, and this bank consent I believe was a requirement of the Justice Department that we disclose to all of our banks that we deal with and what our banking system is.

Besides this bank consent, there was a 15- or 20-page pamphlet, a writeup, which described in detail the way our banking system works in terms of going uncollected—as a matter of fact this morning when there was a—well, you were reviewing many times on how this system worked. That pamphlet would be very good for everyone to have.

Mr. **Morrison**. Do you have access to such a pamphlet?

Mr. **Jensen**. I don't have one with me, but it was mailed to each of my bankers. If you don't have it——

Mr. **Morrison**. I am not aware of it. Which doesn't mean in the reams of documents that we have received it doesn't exist. But if you could with your counsel provide it to the committee, I think we would very much appreciate it.

Could we have a commitment that that could be done?

Mr. **Jensen**. I see no problem.

Mr. **Morrison**. Thank you.

Mr. **Ostrow**. I believe we will be able to supply it, sir.

Mr. **Morrison**. Thank you very much.

[The information follows:]

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400 SOUTH HOPE STREET
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1800 CENTURY PARK EAST
LOS ANGELES, CALIFORNIA 90067-1589
TELEPHONE (213) 553-6700
TELEX 67-4087

610 NEWPORT CENTER DRIVE
NEWPORT BEACH, CALIFORNIA 92660-6429
TELEPHONE (714) 760-9600 · (213) 669-6000
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December
4th
1 9 8 5

OUR FILE NUMBER
408,100-027

WRITER'S DIRECT TELEPHONE
(202) 457-5901

Virginia Sloan, Esq.
Assistant Counsel
Subcommittee on Crime
House Committee on the Judiciary
207 Cannon House Office Building
Washington, D.C. 20515

Dear Ginny,

As you requested, I am enclosing a copy of the letter and explanation of Hutton's cash concentration system that accompanied the bank consent forms sent out in June 1985.

Sincerely,

Zoe E. Baird

insert at bottom of p 132

Enclosure

ZEB:pnc

EFHutton
E. F. Hutton & Company Inc. One Battery Park Plaza. New York, N.Y. 10004 212. 742-6813

Paul Hines
Executive Vice President
and Director

June 4, 1985

Gentlemen:

As you know, both from my letter to you of May 3 and, no doubt, from the press, E.F. Hutton & Company Inc. is now subject to an injunction regarding its banking practices. The injunction requires us, among other things, to disclose to you our cash concentration system insofar as it relates to your bank and to obtain your written consent before we may draw against uncollected funds as part of our system of collected balance management. I am enclosing a memorandum that describes our system and a consent form for your signature. I urge you to read the memorandum and then execute the consent, but I would like to add a few words on E.F. Hutton's overall view of its relationship with its banks.

We believe that our relationship with you should be profitable for both of us. We need to mobilize our cash rapidly and efficiently; you provide us with services to do that and deserve to be compensated for them. Our cash concentration system is therefore designed to move funds as quickly as possible to central accounts while managing the collected balance levels in our branch and regional accounts to achieve a targeted level of compensation.

Properly operated, the system works. The nationally recognized cash management experts at Arthur Young & Co. have analyzed the system, have found it consistent with accepted industry practice as described in the accompanying memorandum, and have determined that (if all funds are collected in one day) the system will produce average collected balances over time that are equal to or greater than the compensation target. We at Hutton are firmly committed to seeing that the system is properly operated so that the abuses of the past do not recur.

As explained in the memorandum, there may be times when, due to clerical errors or a relatively higher proportion of two-day items, the average collected balance in our account runs lower than the target. We will adjust the balance level upward when we see such occurrences, but we also will rely on you to let us know if you believe that adequate compensating balances are not being maintained. If you have a problem, get in touch with Tom Morley at our Money Management Department in New York,

(212) 742-5000. We value our relationship with you and will do our best to make sure that compensation issues get resolved promptly and to our mutual satisfaction.

Sincerely,

Paul Hines

Paul Hines
Executive Vice President
Director

THE E. F. HUTTON & COMPANY CASH CONCENTRATION SYSTEM

Concentration

The E. F. Hutton & Company Inc. cash concentration system is built around the use of daily depository transfer checks (DTCs) to mobilize funds from local branch depository accounts to regional concentration accounts and ultimately to one of the Company's main corporate concentration accounts. In some cases, the Company uses Automated Clearing House transactions for the same purpose. The size of each branch DTC or ACH deposited in a regional account is based on that day's deposit and withdrawal activity at the branch. Concentration points are selected so that, wherever possible, DTCs will be given one-day availability in the regional and national accounts, thereby sweeping funds from the local accounts to the main concentration accounts in one day.

Collected Balance Management

In addition to concentrating branch receipts, the system is designed to manage the average collected balance in the Company's accounts to meet an appropriate compensation target. The target average collected balance is subject to negotiation based on activity in the account. Balances are managed by means of a worksheet that enables us to calculate each day's projected closing collected balance and adjust the size of that day's DTC/ACH accordingly. This process is currently a manual one; as Hutton's Branch Information Processing System comes on line, the calculations will be automated.

The basic principle of the DTC/ACH adjustment process is that if today's closing collected balance exceeds the compensation target, today's DTC/ACH will be increased to reduce tomorrow's collected balance, so that the ongoing average will more closely approach the target. Similarly, if today's collected balance is too low, the DTC/ACH will be decreased so that tomorrow's collected balance will be larger.

The principal sources of potential excess collected balances in Hutton's branch accounts are deposits of immediately available funds, generally "on us" checks or incoming wire transfers. On occasion, float resulting from the failure of a DTC to clear on schedule will also cause excess collected balances. If the target collected balance is $10,000 and "on us" deposits on a certain day are, say, $30,000, then that day's DTC/ACH will be increased by $20,000 (*i.e.*, $30,000 minus $10,000) in order to "recapture" the $20,000 in excess collected balances. Similarly, if a $40,000 DTC fails to clear in one day as scheduled, that amount will have remained on deposit for an extra day, so a subsequent DTC will be increased by $30,000 ($40,000 less the $10,000 compensation target) to recapture this float. By the same token, if "on us" deposits on a given day are less than the target compensating balance, that day's DTC/ACH will be reduced by the amount of the shortfall.

Using the DTC/ACHs to adjust collected balances can and frequently does require issuance of a DTC/ACH drawn against a branch account in an amount greater than the day's deposits to that account. Thus, if a day's deposit consists of $90,000 in one-day items and $40,000 in immediately available items, for a total of $130,000, that day's DTC/ACH might be $160,000, or $30,000 more than the amount deposited. The actual amount will depend on, among other things, the day of the week (to account for weekends) and the current effect of previous balance adjustments. The next day's deposit will generally suffice to cover this DTC/ACH and prevent a ledger overdraft on the bank's books; if it does not, Hutton will deposit a "branch reimbursement check" (generally drawn on United States Trust Company in New York) to make up the difference. Clerical errors and returned items aside, the Hutton concentration system should never produce a ledger overdraft on the bank's books, although Hutton's books will show a credit balance unless the amount of immediately available funds deposited is small.

Although Hutton will generally not overdraw its account on a bank ledger basis; increasing the size of DTCs or ACHs as part of the balance adjustment process may well cause it to draw against uncollected funds. We have attached an example to the end of this memorandum to illustrate this process. Drawing on uncollected funds is a necessary part of the system, but the extent of such drawings is designed to be less than the excess collected balances that are being adjusted for.

The system also takes weekends into account. If a balance adjustment falls on a Friday, it is one-third the size it would otherwise be, since Friday's closing balance will have a threefold effect on the ongoing average. In contrast with Hutton's pre-1982 system, however, adjustment factors that would increase certain portions of Friday or Monday DTCs are no longer in use. Efforts are made to reduce the likelihood of uncollected balances over a weekend, although they remain a possibility in some circumstances. (If your bank is one of the ones with which we have terminal-based reverse wire agreements, we will generally wire out excess collected balances on Friday.)

Potential Issues

The foregoing system works well and, in fact, will generally produce average collected balances in excess of the compensation target. Two circumstances, however, can result in lower balances and therefore require an adjustment. Both circumstances relate to availability assumptions built into the system.

First, the system assumes that all customer deposits that are not immediately available funds are one-day items. We believe this is a reasonable general assumption, since our branches generally serve customers in their own geographic area, but the assumption may not be universally true at a particular branch. (We are currently building an availability matrix into our Branch Information Processing System that will eventually calculate the size of each day's DTC/ACH based on the check-by-check actual availability of our daily deposit at each bank.) To the extent the branch deposit contains a significant portion of two-day items, the system may produce lower average collected balances than it should. The system has some slack built into it, so a small amount of two-day money will probably not produce ongoing balances that are too low, but any problems can be prevented if, when the Hutton branch cashier requests the day's opening balance, you supply the available balance and not the ledger balance. If you are not set up to supply information on opening available balances, it will be necessary to monitor the average collected balance over time and make adjustments as necessary. In any event, if you have account analysis capability and are not already supplying us with account analyses, we hereby request monthly account analysis statements in duplicate -- one copy to the branch and one to our Money Management Department at One Battery Park Plaza, New York, New York 10004.

Second, the system assumes that the "branch reimbursement checks" drawn on United States Trust Company in New York are one-day items. If this is not the case at your bank, please notify our Money Management Department immediately.

Operating Philosophy

It is Hutton's desire that its bank relationships be profitable for both parties. Our system is designed to meet this goal, but we cannot do it all ourselves. If there are compensation/profitability issues you wish to discuss, or if you have questions concerning either the operation of the system in general or its application in a particular case, please call or write to our Money Management Department. Your questions will be addressed promptly.

E. F. Hutton & Company Inc.

Example of Drawing Against Uncollected Funds

Suppose that, on the day the account is opened, the E.F. Hutton branch deposits $130,000, including $40,000 in "on us" items and $90,000 in one-day items. Then, as noted in the memorandum, that day's DTC deposited in the regional concentration account will be increased by $30,000 (i.e., $40,000 less the $10,000 compensation target); since there has been no previous activity, the DTC will be $160,000 (i.e., $130,000 to sweep the day's deposit into the concentration account, plus $30,000 to adjust for excess good funds deposits). The closing ledger balance on the bank's books will be $130,000, and the closing collected balance will be $40,000. Hutton's books will show a $30,000 credit balance.

Suppose that the next day's deposit is $100,000, $90,000 of which consists of one-day items and $10,000 of "on us" items. Then the second day's activity looks like this:

Activity	EFH Books	Bank Ledger	Bank Collected
Open	(30)	130	40
Yesterday's One-Day Items Become Collected	--	--	90
Today's Deposit	100	100	10
Yesterday's DTC Presented	--	(160)	(160)
Draw Today's DTC	(70)	--	--
Close	0	70	(20)

Thus, the closing collected balance on day two was ($20,000), i.e., Hutton drew against uncollected funds to the extent of $20,000. The purpose of this was to compensate for the excess collected balance on day one, and the *average* collected balance for days one and two was $\frac{\$40,000 + (\$20,000)}{2} = \$10,000$, which is right on target.

Mr. **Morrison**. Now, with respect to the memo, the one from Richie Lee, first of all did this memo require your authorization before it went out or—Richie Lee is under your supervision?

Mr. **Jensen**. He is my regional cashier at this time.

Mr. **Morrison**. But he reports to you?

Mr. **Jensen**. That is correct.

Mr. **Morrison**. Did you approve this memo before it went out?

Mr. **Jensen**. Yes, what actually happened here was the national operations had a conference call with all the regional operations managers to describe this policy that Hutton wanted to implement, and we were to implement it as quickly as possible.

[The memo referred to follows:]

[COPY]

TO: Atlantic Region Cashiers/CBOMS
FROM: Richie Lee
DATE: June 18, 1985
SUBJECT: Interim Authorized Drawdown Sheet

The attached is a temporary drawdown worksheet that must be used in place of the previous worksheet. You will noticed it contains the major points covered by Art Jensen's wire of 5/31/85, further review will show this to be easier to execute. To clarify any possible misunderstandings, let me describe two lines as they relate to your present terminology:

New sheet line 2 = Group 1 checks
New sheet line 9 = Group 2 checks

This sheet should be used immediately upon receipt. Be sure to make copies of this plan for further use. Do not, repeat, do not throw out the old worksheets: once your bank consents to our application of the old worksheet we will return to using it.

Last, but mot important, be sure to mark the case and office on the top of the page so we in the region know who sent it.

(SIGNED) Richie

cc: Art Jensen
Jim Kelly
Bob Harlem (unreadable)
Micro Teta (unreadable)

NOTICE: If the film image below is less clear than this notice, it is due to the quality of the document being filmed.

TO: Atlantic Region Cashiers/CSOMS
FROM: Richie Lee
DATE: June 18, 1985
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Last, but most important, be sure to mark the date and office on the top of the page so we in the region know who sent it.

Richie

cc Art Jensen
Jim Kelly
Bill Harlow
Vince Teta

NOTICE: If the film image below is less cl
notice, it is due to the quality of the document

E.F. HUTTON & COMPANY INC.
STANDARD BANK CONSENT

______________________________ (the "Bank") agrees that E.F. Hutton & Company Inc. ("Hutton") may from time to time draw against uncollected funds in its depository account(s) number ____________________________ (the "Account(s)"). The Bank further agrees that Hutton may from time to time draw depository transfer checks against the Account(s) in amounts greater than the funds received from Hutton's customers or institutional clients in the ordinary course of business and deposited in the Account(s).

The Bank may charge Hutton its prevailing charges (in fees or balances) for drawings against uncollected funds, and this consent shall not be construed as a waiver of such charges.

This consent is revocable at any time at the Bank's option. Revocation of consent may apply to a single transaction, to a series of transactions, or to the entire operation of (any or all of) the Accounts(s).

Bank: ______________________________

By: ______________________________

Name:
Title:

Date: ______________________________

Mr. **Morrison**. And you were told I assume that this was being implemented pursuant to a consent decree, in other words, that there was—or were you not told that?

Mr. **Jensen**. I am not sure whether this was—I think this was implemented on Hutton's own volition. I cannot swear to that.

Mr. **Morrison**. In any case, as far as you recall, you were not told that E.F. Hutton was being ordered to do something like this or at least to implement this through drawdown procedure?

Mr. **Jensen**. The second page, yes.

Mr. **Morrison**. Second page, yes. Not the procedures on the first page?

Mr. **Jensen**. Correct.

Mr. **Morrison**. OK, now, in this memo it has an interesting statement which is, do not, repeat, do not throw out the old work sheets. Once your bank consents to our application of the old worksheet, we will return to using it.

Now, you approved that message to go out to your cashiers around the region.

Mr. **Jensen**. Well, I think the message was two things here, No. 1, around this time I believe there was, maybe the subpoena from this group, No. 1, keep all your records in case they are needed. So I think Richie was probably talking about let's make sure we keep those.

The second thing was that when the conference call was made describing this procedure, it was also noted in the call that once the banking consent, the second one has been signed, Hutton would be able to go back to some form of the drawdown sheet. At that time, it wasn't explained to us whether it would be the same sheet or a different sheet.

Mr. **Morrison**. So it is your understanding that if the bank signed this consent that the drawdown sheet that was in use prior to June 18 or so of 1985, was legal?

Mr. **Jensen**. Well, no. Let me clarify that. Once the bank—once the bank had signed this consent, copies had to be sent up to my department and they had to be turned over to our money management area and the money management area would notify the branch and myself or my agent when and what form of drawdown could be instituted at that time.

It did not mean no one had permission to go back to the original drawdown sheet, even though it was inferred and as a matter of fact, since it has been more than inferred, I saw a prototype of the new one a few days ago that Hutton will be going back with the approval of banks to going uncollected at times. Banks have no problem with this.

Mr. **Feighan**. The Chair will say we will be able to return to this questioning. I think it is extremely important that we do. Since there is a rollcall in process, we will recess for approximately 15 minutes.

[Recess.]

Mr. **Feighan**. The Subcommittee on Crime will resume.

For purposes of concluding the discussion on the memo at hand, the Chair will recognize the gentleman from Connecticut.

Mr. **Morrison**. Thank you, Mr. Chairman.

Mr. Jensen, if we could focus for a moment on this standard bank consent and go through it just so we understand what it says and what it means.

Mr. **Jensen**. Yes.

Mr. **Morrison**. What it means about what Hutton is arranging with its banks to do something which may be the same or different from what it has done in the past.

The memo is obviously a voluntary thing, the banks don't have to agree, although you can shop around for banks that will, as I understand, is that correct?

Mr. **Jensen**. Personally in my region I am having a very good response where a lot of bankers are signing it. Some of them are still looking at it but——

Mr. **Morrison**. OK, but you said there was a booklet that you were going to supply to us and that booklet is the expansion on what these words mean. Do I understand that this goes with the book and what is being talked about here is what will be explained in more detail in the booklet?

Mr. **Jensen**. The booklet describes exactly how our system of concentrating and collecting funds works, that we will be uncollected on the bank's books, we will be uncollected—we will be taking—recapturing float in effect, the same way, not the same way but the same principle as it was previous.

This has been approved by the Justice Department.

Mr. **Morrison**. Now, there is a question of essentially trying to recapture float and something that is called excessive overdrafting or has been called excessive or abusive overdrafting.

Which I take to mean creating float the other direction, if you will. Beyond just recapturing the float, essentially creating balances that reach into the bank's assets, reach into the bank's profits from other accounts and making money off the banks.

Do you understand there to be such a distinction or do I misunderstand?

Mr. **Jensen**. I don't believe that the recapture of float ever meant that we were going to take money from the banks or try and do harm to them monetarily. That is not what the recapture of float is.

Mr. **Morrison**. The focus here I guess—let's focus on the document. What this says essentially is that you will draw against uncollected funds.

Mr. **Jensen**. That is correct.

Mr. **Morrison**. My laymen's reaction to that is uncollected funds implies that they are to be collected. And I wonder whether that is true as opposed to funds that never really existed.

In other words, let me give you an example. If a check is deposited for $100 but it is uncollected, you might draw on that $100 before it is collected and that would be drawing on uncollected funds. If there is no other deposit coming and you write a check for $200, is that equally a draw against uncollected funds or does there have to be some expected collection or does that distinction not mean anything?

Mr. **Jensen**. No, the same distinction applies under the—under the old drawdown system if we can simplify it where I make a—I have collected funds on say a cash deposit of $100 in the account.

And since the cash deposit is good immediately, in effect what the drawdown under the old system would do is you would end up drawing a check for $200, the reason being is that when I write that check in New York today, it takes 1 day for that check to get back to the bank.

The bank has had the money yesterday, for $100 which was good, didn't have to be collected because it was cash or Fed funds; they had the money today for $200. I wrote the check for $200 yesterday, I only had $100 there, so I am recapturing the float, today when that check gets to the bank, I will have to replenish the bank with a $100 check or deposits; if I have no deposits I will have to write out a reimbursement check.

That same principle in 1981 is going to apply in 1985 and it has been approved by the Justice Department. There have been some minor—there have been some modifications to the formula but the concept is the same, providing that we receive the consent on this form of every bank where the bank knows and has signed off that they know what we are doing.

Mr. **Morrison**. Then I have just one more point I want to clarify, and that is I understand that there is a distinction between with and without consent of the bank. That was clearly one concern of the Justice Department. That is addressed by getting their consent. I suppose if the banks consent you can, at least as far as the banks are concerned, write a check for anything you want. It is essentially taking a loan from the bank.

But is there any other constraint on this system? In other words, could you draw in that circumstance $300 or $400?

Mr. **Jensen**. You cannot——

Mr. **Morrison**. What draws that line? What is it that makes you stop at $200 rather than drawing a check for $500 in that circumstance you just told me about, which is basically a 1-day float you are trying to recapture?

Mr. **Jensen**. Well, one thing that happened in the past where someone wrote a check for, say, no reason, they did not follow the drawdown sheet. That is an illegal. You have to follow the drawdown sheet 100 percent. If the drawdown sheet, when you do your calculations——

Mr. **Morrison**. Excuse me. There is no—the statutes do not have a drawdown sheet. You are saying because the Justice Department approved the drawdown sheet——

Mr. **Jensen**. They approved the concept of where we can go uncollected providing that the banks are aware of it. This is something that has happened for years.

Mr. **Morrison**. In other words, you could write a $500 check if the banks understood that that is what you were doing and approved it?

Mr. **Jensen**. I could not—I am——

Mr. **Morrison**. I want to get us to the specifics. There is a line here. As I understand the judgment, the banks have to consent but also excessive and abusive overdrafting is also forbidden, which is something else, and I am trying to find what that something else is.

Mr. **Jensen**. I think what you are getting at is I cannot make a $500 deposit and write a check for $50,000. You would not be following the instructional sheet approved, which is similar to the one earlier. OK?

Mr. MORRISON. Well, Mr. Chairman——

Mr. JENSEN. What happens here is, in effect, when we go uncollected, at the month end, the bank will do an analysis and they will find that their account is profitable. It has always been Hutton's policy that we want to pay for our services and that is what happens here. We are recouping.

Mr. MORRISON. Mr. Chairman, I think we have exhausted this.

Mr. FEIGHAN. OK. Mr. Jensen, let me ask you a few questions that I think are fairly simple that would enhance my understanding of exactly how E.F. Hutton conducted its cash management activities, particularly from the perspective of the regional manager.

The regional operations managers, such as yourself and the branch managers of E.F. Hutton, had a drawdown formula that they were obligated to respect with—that was setting the parameters to ensure that any overdrafting that E.F. Hutton was engaged in would be done in a legal sense. Is that a fair statement?

Mr. JENSEN. That is correct.

Mr. FEIGHAN. Do I understand correctly, based on some of your responses to questions just posed to you by the gentleman from Connecticut, that the drawdown formula that the regional manager was obligated to follow and that the branch managers were obligated to follow was, in fact, a worksheet as you have described it, that that really was the worksheet? The drawdown worksheet was, in effect, a statement, a physical document representing the drawdown formula; is that correct?

Mr. JENSEN. It was a worksheet. Every day you would pull a new worksheet out and fill it out in the branch per the——

Mr. FEIGHAN. So this formula and worksheet was an effort by E.F. Hutton executives to assure that the overdrawing activities that they were engaged in would be legal and that going beyond the parameters of the formula would be stepping into the realm of illegal activity? That was the purpose of the formula?

Mr. JENSEN. It was company policy to follow the formula—yes.

Mr. FEIGHAN. I assume the company policy in providing the formula was to ensure that the transactions of E.F. Hutton would be legal and ethical.

Mr. JENSEN. Legal, ethical, and to ensure that we were handling our accounts in a businesslike profitable manner, yes.

Mr. FEIGHAN. Could you tell us who Mr. James Kelly is?

Mr. JENSEN. James Kelly is the vice president who handles my branch liaison and cashiering functions. I have two people mainly reporting to me directly: Mr. Kelly and Mr. LaRosa who runs the margin department for E.F. Hutton.

Mr. FEIGHAN. Thank you.

Let me, if I can, show you a memo and I would ask that this memo be entered into the record. This is a memo, on E.F. Hutton memorandum stationery, dated June 2, 1981 from Mr. James Kelly to the Atlantic Region cashiers. Without objection, it will be made a part of the record.

[The information follows:]

49-507

E.F. Hutton
INTER-OFFICE MEMORANDUM

TO Atlantic Region Cashiers
FROM James Kelly
DATE June 2, 1981
SUBJECT Reminders from Seminar

Below is a list of reminders from our recent Cashiers Seminar.

1.a) Do not hold securities in the branch if waiting for legal papers.

Ship all securities to N.Y. the day they are received from clients.

b) Do not send legal papers to N.Y. unless N.Y. has a legal full paid security.

c) Use new Legal Security Unit Form 2636, dispose of old Forms 2656. Revised Form 2636 Legal Full Paid must include only one security for each form.

d) Follow up with A/E's for legal item pending papers every Monday.

2. Follow up with A/E's for securities which need stock powers from Stock Power Listing.

3. Obtain a letter signed by the customer to swap coupon bonds to registered.

4. Make deposits to bank daily up to ½ hour of closing.

5. Run two tapes for checks received. One tape from blotter and one from actual checks received.

6. Utilize Express Mail (U.S. Post Office) if available when shipping Bearer Bonds to N.Y. You may ship up to $3,000,000 per package, per day. Report total shipments separate from 1st class and registered to Legal and Compliance yearly.

7. A letter of authorization from the client must be obtained when changing Joint name stock to an individual.

8. Follow up on all letters sent to client form 3063 when an A/E hand delivers a check or security to a client.

9. Lock up everything in Cashiers area before leaving each night.

10. Correct Bank Reconciliation differences immediately upon receipt of Bank Reconciliation from Hugh van Bergel;

This is extremely important, it must be done!

11. Drawdown as discussed. You may drawdown more than formula but not less! This will depend on individual Branch/Bank circumstances.

James Kelly
James Kelly

Mr. **Feighan**. If you would review this memo as briefly as you can, I would have a number of questions on it.

I would like, if I could, Mr. Jensen, to call your attention to page 2 of the memo. As I understand, the memo that we are reviewing was sent from Mr. Kelly of your office to all Atlantic region cashiers. A copy was also sent to you. The last item on the memo I find particularly interesting. It says, "Drawdown as discussed. You may draw down more than formula but not less. This will depend on individual branch/bank circumstances."

"You may drawdown more than formula but not less," virtually instructing those cashiers to draw down more than the formula, virtually instructing them to go beyond the very parameters that you have said E.F. Hutton set in order to ensure that the transactions would not overstep bounds of legality.

In fact, you have said just a few moments ago in response to another question, "You have to follow the drawdown sheet 100 percent." You cannot go wrong, you said, Mr. Jensen, if you follow the drawdown sheet.

Simultaneously, your office has recommended to the Atlantic region cashiers not only should they go beyond the formula but they must do no less than the formula. Does not that really go to the very heart of the criminal activities that Hutton is alleged to have engaged in? It says the formula may, in effect, be totally disregarded so long as it is exceeded.

Mr. **Jensen**. I do not—I do not know where Mr. Kelly received this information at this seminar. He may have taken something out of context, but that was not my policy and not the firm's policy.

Mr. **Feighan**. Mr. Jensen, did not I understand you to say that Mr. Kelly is one of two individuals who report directly to you? Did I understand that?

Mr. **Jensen**. You did.

Mr. **Feighan**. And I note here that a copy of this memorandum was sent to you. Is that correct?

Mr. **Jensen**. My name is on there. I do not remember it, but my name is on there.

Mr. **Feighan**. You do not recall seeing a copy of this memo?

Mr. **Jensen**. No, I do not.

Mr. **Feighan**. Do you not find it rather startling that your cashiers would be advised by one of the two individuals reporting directly to you that they should draw down more than the formula, that they exceed the parameters, that they should step into those bounds, perhaps stepping into the bounds of illegality that you were attempting to guard against and you are not aware that that is the advice, instructions literally that they are receiving?

Mr. **Ostrow**. May I confer with my client?

Mr. **Feighan**. Excuse me?

Mr. **Ostrow**. May I confer with my client?

Mr. **Feighan**. Please do.

Mr. **Jensen**. I can think of one example. As a matter of fact, I can think of more than one example now, and let me go into some of the reasons of what probably was behind Mr. Kelly's mind.

I will give you a—give you something that is very recent, a couple weeks ago. A couple weeks ago we had a check, not a check, a wire for Fed funds sent to a large bank in Ohio and it was received in the bank at 5 minutes to 4 or 2 minutes to 4, something like over $1 million and it was on a Friday.

The bank earned interest on the million dollars, really not 1 million, turned out for 3 days they made interest on $3 million for the weekend because they could not turn around and they did not notify us in a timely manner.

We complained to the bank and the bank told me, well, we cannot give you a check for the value of that money that we owe you, but it is OK if you want to go uncollected with us to collect that.

Now, if we were uninformed—we did not collect because we were on that other formula. We left it there and the bank made the $3 million interest profit. At this time if the bank notified us of a mistake they had made and told us that it is OK with them to go uncollected, we would go uncollected and I believe that is what Mr. Kelly stated here.

Mr. FEIGHAN. What you have just described, Mr. Jensen, you would acknowledge is a very unusual circumstance; is that not correct?

Mr. JENSEN. I would not say they were—they are not unusual, especially with Fed funds.

Mr. FEIGHAN. What you have described is an infrequent circumstance?

Mr. JENSEN. A couple times a week it could happen. We have a lot of banks, and I find a problem with banks on Fed fund transfers where they come into the bank and it takes a day before they notify Hutton that the money is there. So, in effect, if they would have told us today the money was there, we would have used it. At this time I think what Mr. Kelly is saying is that if the bank tells you the money was there and they approve it, we will take it back.

Mr. FEIGHAN. Mr. Jensen, by way of conclusion, let me identify a couple other recommendations in this memo which I think give the nature of this memo. It is talking about regular business activity, "Lock up everything in cashiers area before leaving each night. Follow up on all letters sent to client form 3060 when an A/E hand delivers a check or security to a client."

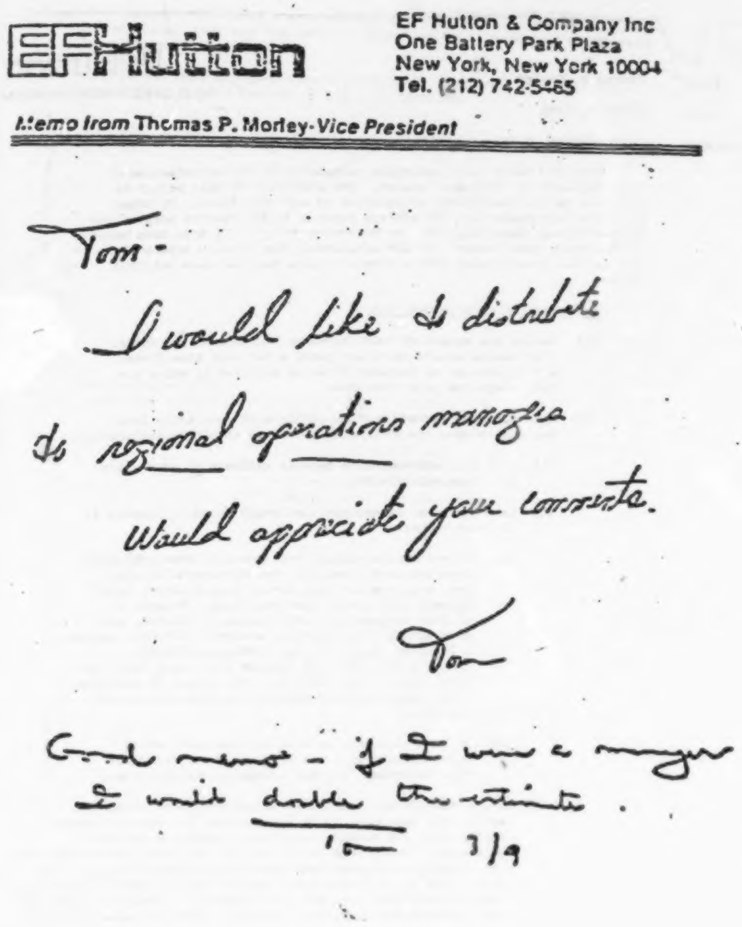
This is a memorandum that is summarizing the specific day-to-day operations discussed at the cashiers' seminar sometime shortly before June 2, 1981. I think not only is this memorandum instructing those cashiers to go beyond the parameters that that formula was or had set, but this seems to be very clear, in fact, that at that seminar there must have been a full discussion of how and under what circumstances there should be an extension of activities beyond the parameters of the formula.

The gentleman from Florida.

Mr. MCCOLLUM. Mr. Jensen, I think this is the last document that we have up here, but I would like for you to look at a document, if the memo could be distributed to you, dated March 6, 1981, from Tom Morley to the distribution list. Attached to that is a cover with respect to that that appears to be a memo on it, and the title is "Anticipation of Late Deposits." I would like un consent to have this entered into the committee record.

Mr. **Feighan**. Without objection, it will be entered record. So ordered.

[The information follows:]



EFHutton

EF Hutton & Company Inc
One Battery Park Plaza
New York, New York 10004
Tel. (212) 742-5465

Memo from Thomas P. Morley - Vice President

Tom -

I would like to distribute to regional operations managers. Would appreciate your comments.

Tom

Good memo - If I were a manager I would double the estimate.

Tom 3/9

Distribution List

FROM Thomas P. Morley

EF Hutton
INTER-OFFICE MEMORANDUM

DATE March 6, 1981

SUBJECT Anticipation of Late Deposits

Outlined below is a procedure pertaining to the anticipation of late deposits by the local branch. The adherence to this policy is critical to insure maximum utilization of our cash flows. It takes on added importance for the offices located in the Western part of the United States since they have to determine their daily draw down based on New York time frames. We are addressing that problem separately, but in the interim each office should follow the procedure outlined below.

Anticipation of Late Deposits -

(1) Review the amount of late deposits your branch is making. This review should cover at least a two week time frame. A late deposit is defined as being received in after you have completed your draw down.

(2) Once you have established an estimate of your daily late deposit volume, the following procedure should be implemented.

  (1) Each day, add the late deposit estimate to your daily draw down calculation.

  (2) Once you have determined the actual deposit, compare it to your estimate.

    (a) If you overestimated your deposit, draw a Chemical Reimbursement Check for the difference between your estimate and the actual late receipts, and deposit this check into your bank. Example - If your estimate of late monies is $50,000, and your actual late receipts amount to $30,000, prepare a Chemical check for the difference $20,000 ($50,000-$30,000) and deposit this check into your local bank. This will have the effect of balancing your ledger balance relative to your anticipated deposit.

    (b) If your estimate is smaller than your actual late deposit then use the excess as good funds the following day, and increase your estimate.

(3) In no circumstance should we accept customer checks for credit the same day, if it is received too late to deposit in the bank and receive that day's credit on our bank statement. Every bank has a cut off time after which they will not accept our deposit and credit our account that day. We should strive to extend that time as late as possible but once this cut off time has been established, we should use this as our deadline for accepting customers check for same day credit.

Remember your branch gets charged for any debit balance maintained in your local bank account so it is important to estimate your late deposits on the high side.

If you have any questions regarding the above mentioned procedure, please feel free to contact me for clarification.

Tom

Distribution List:
Operation Regional V.P., Boston (Bob O'Neil)
" " " Chicago (Mike Goldstein)
" " " LA (Bob Mercer)
" " " Atlanta (Joe McAdams)
" " " Denver (Joe Padilla)
" " " Houston (Gerald Webber)
" " " Kansas City (Michael Wallace)
" " " New York (Art Jensen)

Copy to:
Norman Epstein
Robert Ross

Mr. **Feighan**. Mr. McCollum.

Mr. **McCollum**. Do you have a copy of that or has it been distributed?

Mr. **Jensen**. No, I do not. Was it given out?

Mr. **McCollum**. No, I do not think so. I will get one for you. Staff seems to be having a problem with it.

There is a cover note from Tom Morley's office to a "Tom." Then there is the response and then there is a distribution list itself and "Anticipation of Late Deposits" dated March 6.

If you would like to look at the actual memo a little bit I would appreciate it if you would glance over it.

Mr. **Jensen**. Yes.

Mr. **McCollum**. You will notice on the last page there is very little there, but there is a list of the distribution, including your name on it. Do you have any independent recollection of this, receiving this particular memo?

Mr. **Jensen**. I remember, not really the memo, but I remember Tom Morley discussing this at one of the meetings we were at somewhere.

Mr. **McCollum**. Let me ask you this. In looking at the cover memo, the little handwritten one on top, the one that is from Tom to Tom, there is a response at the bottom reading, "Good memo—if I were a manager I would double the estimates. Tom, 3/9."

Do you recognize the handwriting at the bottom?

Mr. **Jensen**. No.

Mr. **McCollum**. OK.

Mr. **Jensen**. It is not mine.

Mr. **McCollum**. In the normal course of affairs is it a safe assumption that the likelihood is the Tom to whom this was directed by Tom Morley in March 1981 would have been Tom Lynch?

Mr. **Jensen**. I really have no way of knowing.

Mr. **McCollum**. I know you have no way of knowing. I do not expect you to say that is the case, that you do not recognize the handwriting—I do not know either. But were there any other Toms to your knowledge that were supervisory related to Mr. Morley in your operation in this area that would be those you can recall who were there at the time and likely to receive a request for approval or comments or something like this?

Mr. **Jensen**. A lot of people have come and gone since then, but——

Mr. **McCollum**. You cannot think of anybody else besides Mr. Lynch?

Mr. **Jensen**. No, but who knows.

Mr. **McCollum**. I would like to address the contents of this just so we understand it as clearly as we can, the anticipation memo itself. What it appears Mr. Morley is saying in this memo is that he wants the branch managers, you overseeing them as regional personnel since that is who it is directed to, to add something new to the amount drawn down each day. Is that not what he is saying? He wants you to estimate the deposits that might come in later in the day after you have issued the drawdown or after the branch manager issued the drawdown and then draw an additional amount down equivalent to that estimate of what might come in in the way of a deposit?

Mr. **Jensen**. That is what he outlines here. We did not do this in the Atlantic region, and the reason for that is that all of the money moved from West to East and the problem of west coast, as I understand it was having, the problem they were having is that due to the time differential the drawdown figures from their branches had to be reported to New York while the offices and banks in California were still open, and so at the same time that we were taking checks from our customers, say at 3 o'clock—say at 2:30 in Los Angeles that figure for the day's drawdown had already been reported to New York.

We had to give our customers—if you brought the check in, say it was your account, it would have to be credited to your account if you were purchasing a money market fund or whatever. It had to be a transacted transaction. We could not tell you, well, New York has already closed down, come back tomorrow. You would say, well, my bank here is still open. You know, how do you do that?

So what Mr. Morley was doing here was saying that taking an average on how much of these deposits you get after your are drawn down into the region to New York, and what he was saying is that the money would be collected by the banks, it would be good funds, they would show on their analysis, the bank would not be injured. So he was saying, in effect, to recapture some of that money. I am sure they probably talked to the banks they were dealing with about this——

Mr. **McCollum**. But you do not know that.

Mr. **Jensen**. I do not know that, but the one thing that strikes me with all this banking topic is that if you constantly do take advantage of a bank they are going to do an analysis and catch you. There is one example——

Mr. **McCollum**. And they did in one case here.

Mr. **Jensen**. I am not saying, you know, I have heard—I have read in the paper, put it that way, that one thing that—I do not know if it was the Justice Department or maybe it was Reuters or what not, claimed that maybe the banks did not know.

If you yourself have a checking account and you overdraw or write a check for $10 more than you have in that account, say you only have $200, it is a very small amount. Banks will bounce your check immediately. Every American citizen, even myself I have done it from time to time, made a mathematical error, and that check bounced.

How can anybody feel with an account like E.F. Hutton which has hundreds of thousands of dollars in it that they will monitor your account but not mine? It is inconceivable.

Mr. **McCollum**. Mr. Jensen, without trying to defend the banks' role or practices, and there are certainly plenty of them that I have seen that I do not approve of, the question really is begging itself in this instance because you and I both know that with the size volume we are talking about and instances here where the banks are not aware of the monitoring you are talking about to the degree that would allow them in every case to pick this up, I suspect while you are saying that they do know it, to the extent they know maybe they did. It does not necessarily make this right, and there was no actual agreement and, in fact, the sums involved at times got further away when you were engaged or Hutton was in the practice of a policy described by Mr. Sullivan that seems to be one thing, but when the policy got to the so-called aggressive nature where instead of following a work sheet you were given estimates even though you say you did not do it in the Atlantic region, obviously in essence knowing this was probably followed in other areas of the country, you are then giving wide latitude, it seems to me, to encourage those people out there in the field managing this to do creative aggressiveness and that seems to be at the minimum of what happened with Hutton.

It just seems like to me that what Mr. Morley is saying in this memorandum is that you got plenty of leeway out there in the field to do some estimates, let us make sure we do not miss a penny. Let us double up if we have to is what the response of whoever the mysterious Tom was that he consulted with, and that overaggressiveness is what got Hutton into the problems you got into. I am not defending banks, but I am saying it seems to me that Hutton has made a lot of money here off people for their own benefit in double-triple quantities. Sort of like is that good or is that bad, I would say I think as a matter of public policy it is a good question. You know, that is a very important question. Banks are regulated in a way for this purpose. Perhaps we do not do a good job of that in all cases. Hutton certainly is regulated by the securities agency, but it is not regulated for this kind of what I would call creative loan making which is basically what it was after it got away from strictly recapture.

At any rate, my point was not to ask you a lot of questions about something that did not go on in your region, but I wanted to get this document in. I wanted it identified if we could. I think we have done that.

I have completed my questioning. Thank you, Mr. Chairman.

Mr. **Feighan**. The gentleman from Connecticut.

Mr. **Morrison**. There is one more document, I think, that we might usefully get in at this point, and that is the memo from Mr. Jensen to Tom Morley dated May 20, 1985, with the attached letter to Mr. Fomon from Donald G. Pepper, dated May 8, 1985.

Mr. Chairman, if that could be admitted into evidence.

Mr. **Feighan**. Without objection, it will be entered as part of the record. So ordered.

[The information follows:]

TO: Tom Morley
FROM: Arthur Jensen
RE: Provident Bank
DATE: May 20, 1985

In reference to the attached letter to Mr. Fomon, I have reviewed the Hutton-Provident banking relationship with Mr. Pepper. I have asked Mr. Pepper to provide us with a monthly account analysis. I have assured him that we will wire Federal Funds to cover any uncollected positions in our account. Under the present drawdown procedure, the account should not be uncollected at any time.

Mr. Pepper was receptive to my telephone call and will contact me directly with any future problems.

AJ/ea
Attach.

The Provident Bank
One East Fourth Street
Cincinnati, Ohio 45202
513/579-2004

Donald G. Pepper
Senior Vice President
Operations

May 8, 1985

Mr. Robert Fomon
Chairman
Chief Executive Officer
E. F. Hutton & Company Inc.
One Battery Park Plaza
New York, N. Y. 10004

Dear Mr. Fomon:

Your letter to our former Board Chairman, Mr.Joseph F. Rippe,dated May 3, 1985 has been referred to me for reply.

To say that we have "probably noted in the media" that Hutton has recently entered a plea of guilty is the understatement of the day. Provident Bank has been mentioned in a number of press articles which we find rather disturbing. As you probably know, the financial climate in Cincinnati, as a result of the Home State Savings failure, is not the best, and we have received numerous telephone calls concerning our $13,000,000.00 exposure to you during the period in question.

I find the remainder of your letter and the attached verbage in the press releases, to be somewhat confusing, and I must express my sympathy to you. It's always embarrassing when someone in the organization does something which contradicts your intentions. I refer specifically to the fact that yesterday it was necessary for us to return a $297,000.00 DTC because it was drawn against uncollected funds. I don't know what the communication problem is in your organization, but we will not honor any checks, now or in the future, which are drawn against uncollected funds. Items drawn against uncollected funds will be returned, and your account will be appropriately charged under our existing schedules. We look forward to receiving further information.

Very truly yours,

Donald G. Pepper

DGP/ejb

Mr. Morrison. This is somewhat more recent, so I think you would probably remember this. Do you recall this?

Mr. Jensen. Yes, I recall it.

Mr. Morrison. This exchange, OK. And I guess my only question about it is when I asked you earlier about the response of banks to this—to their offer to put in writing what—there has been some disagreement about whether the banks understood all along or they did not, but it certainly was not in writing.

Is this Provident Bank reaction which seems to be somewhat less than cordial, is that unusual or do we misunderstand the document?

They have said basically we will not honor any checks now or in the future which are drawn against uncollected funds. That seems a pretty flat statement. Is that unusual as a response?

Mr. Jensen. This is very unusual, first of all. I have spoken to Mr. Pepper. When there is a problem on drawing on uncollected funds, there is usually a number of things that have to be researched. One would be, you know, the availability that the bank is giving us. Are they giving us 1-day money or are they giving us a lot of 2- and 3-day money? If they are, it is definite that the formula will not work—even the old one. That formula was predicated, and even the new one is, on getting 1-day money. So once we find out that maybe there is too much 2-day money from a bank, then we would—we have a problem. We have to stop. We have to really slow down our drawdown. But his analysis, he might be making—he might like to make more money. We do not mind him making money, but maybe we can find another bank that will give us 1 day.

But when I spoke to him, I did not understand why he was having this problem. I told him that if you do have any problem, No. 1, we will wire you Fed funds immediately, as he knew in the past we want to make his account profitable. It is just my statement that I do not have these problems with other banks, and that he is not giving me the availability that the firm requires.

Mr. Morrison. Mr. Chairman, I have no further questions.

Mr. Feighan. Thank you for your testimony, Mr. Jensen.

Mr. Morrison [presiding]. I would like to call as the next witness Mr. Ernest Dippel. Mr. Dippel is the regional vice president for the central region of Hutton. He joined the Hutton Co., in 1973, was branch manager in the Kansas City branch office until February 1982. Kansas City is in Hutton's central region. In 1975 or 1976 he became a part-time regional sales manager and in 1982 full-time as he gave us his position as branch office manager.

On behalf of the subcommittee we welcome you. Let the record ndicate that pursuant to clause 2 of rule XI of the Rules of the House of Representatives, copies of the rules of the Judiciary Committee and of clause 2 of rule XI of the Rules of the House are available at the witness table.

Mr. Dippel, you have a right to counsel to assist you in the proeedings. Are you accompanied by counsel?

Mr. Dippel. I would like to present Mr. Tom Kafler, my attorney.

Mr. Morrison. I am now going to place you under oath. Please tand and raise your right hand.

[Witness sworn.]

TESTIMONY OF ERNEST DIPPEL, REGIONAL VICE PRESIDENT, CENTRAL REGION, E.F. HUTTON

Mr. Morrison. You may proceed at this point to give whatever prepared statement that you have. As I understand it, we don't have any written prepared statement. If you would like to proceed.

Mr. Dippel. I am prepared to answer questions.

Mr. Morrison. So you have no statement that you wish to make?

Mr. Dippel. No.

Mr. Morrison. If we could start by directing your attention to your activities as Kansas City branch manager. Could you explain what your responsibilities were in that capacity with respect to the cash management activities of the branch?

Mr. Dippel. In the Kansas City branch this was a branch attached to a regional office, and our regional cashier, Betty Smith, handled the cashiering for that branch. So I had no responsibility for the Kansas City branch.

Mr. Morrison. No responsibility at all?

Mr. Dippel. I would say I had no activity. Certainly as branch manager I had a responsibility, an overall responsibility. She handled 100 percent of the cashiering, so there were no management decisions to make.

Mr. Morrison. There was no separate branch cashier in your branch?

Mr. Dippel. That is correct.

Mr. Morrison. And Betty Smith was regional cashier and she did all of that?

Mr. Dippel. Yes, and that arrangement existed for many years.

Mr. Morrison. When you became regional sales manager, first part time and then full time, what association if any did you have with the branch managers with respect to cash management?

Mr. Dippel. Well, as regional sales manager, my main thrust was the—was sales motivation and recruiting of account executives, and more importantly, opening offices. So I had no cash management responsibilities at all. I became involved on the fringe of cash management activity in June 1981.

Mr. Morrison. And how was that?

Mr. Dippel. In June 1981 we learned through some comparisons that we were the cellar club as a region. We were last in interest income as related to gross income. We were about 20 percent worse than the average in the firm, which is a situation uncharacteristic for the central region, a region that last year was region of the year.

Mr. Morrison. Last year meaning——

Mr. Dippel. 1984. We had great productivity in many areas, but in interest income we were retards.

Mr. Morrison. Excuse me, but how did this come to your attention?

Mr. Dippel. It came to our attention through the ranks and direct contact with Mr. George Ball, then president of E.F. Hutton.

Mr. Morrison. So George Ball made a point of the fact that you were not doing well in that regard?

Mr. Dippel. Yes, he did. And the timing, in June of 1981, coincided with a meeting that we had for branch managers in New York.

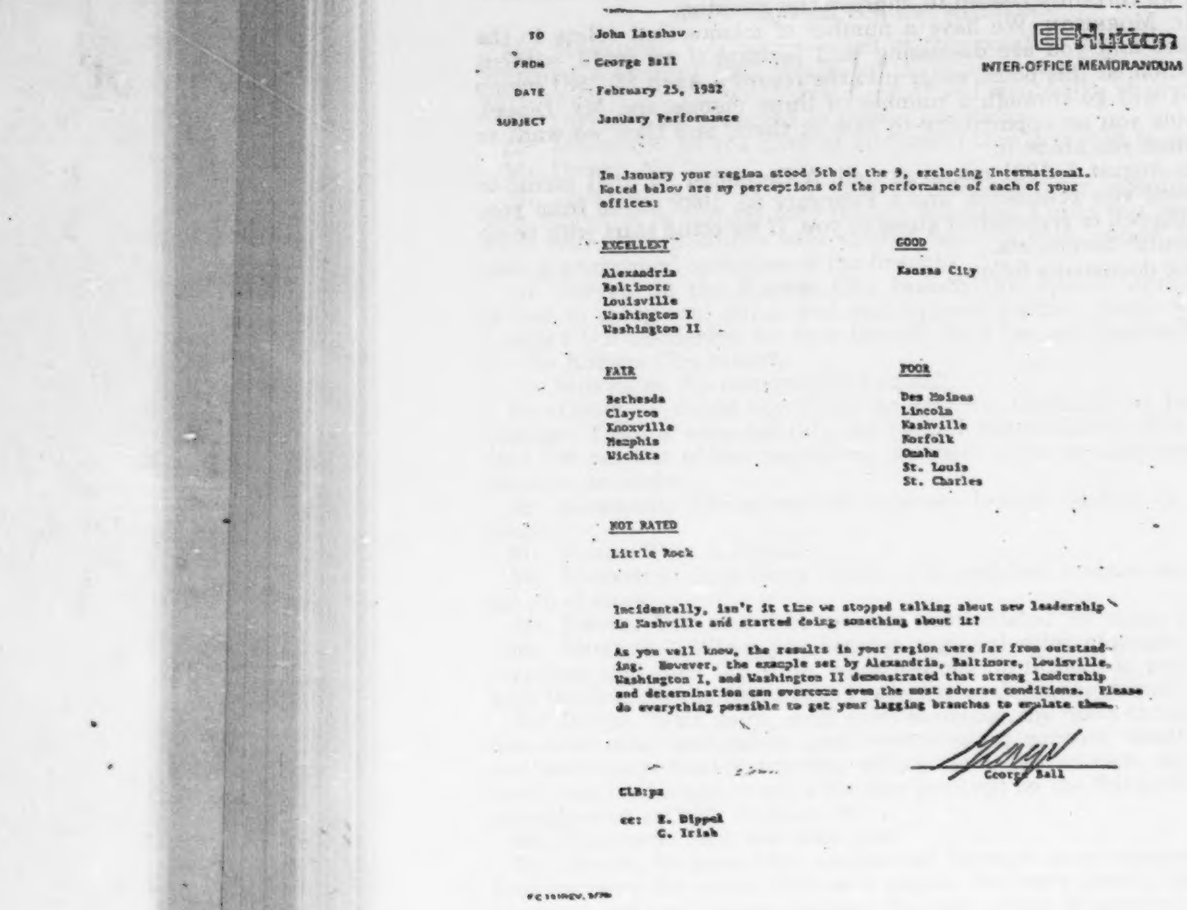
READEX FICHE

Mr. Ball indicated to our regional vice president, John Latshaw, that we certainly needed to improve this ranking.

Mr. MORRISON. We have a number of memos that relate to the subject that you are discussing, and perhaps if we could, without objection, at this point, enter into the record a April 27, 1981 memo and I will go through a number of these memos and Mr. Dippel, provide you an opportunity to look at them, and then we want to question you about it.

An August 5, 1981 memo as well. A December 18, 1981 memo to regional vice presidents, and a February 25, 1982 memo from you, Mr. Dippel, to regional—I guess to you. If we could start with those particular documents.

[The documents follow:]



EFHutton
INTER-OFFICE MEMORANDUM

TO John Latshaw
FROM George Ball
DATE February 25, 1982
SUBJECT January Performance

In January your region stood 5th of the 9, excluding International. Noted below are my perceptions of the performance of each of your offices:

EXCELLENT

Alexandria
Baltimore
Louisville
Washington I
Washington II

GOOD

Kansas City

FAIR

Bethesda
Clayton
Knoxville
Memphis
Wichita

POOR

Des Moines
Lincoln
Nashville
Norfolk
Omaha
St. Louis
St. Charles

NOT RATED

Little Rock

Incidentally, isn't it time we stopped talking about new leadership in Nashville and started doing something about it?

As you well know, the results in your region were far from outstanding. However, the example set by Alexandria, Baltimore, Louisville, Washington I, and Washington II demonstrated that strong leadership and determination can overcome even the most adverse conditions. Please do everything possible to get your lagging branches to emulate them.

George

George Ball

GLB:pz

cc: E. Dippel
C. Irish

EFHutton
INTER-OFFICE MEMORANDUM

TO Regional Vice Presidents and Regional Sales Managers
FROM George L. Ball
DATE December 18, 1981
SUBJECT Region of the Month

The operating environment in November was quite similar to that of the preceding month. Within that context, the absolute results and improvement shown by the New England region were exceptional, as were those of the close-contending Atlantic and Midwest regions.

Exceptional, too, is the type of performance that we must have from each of you to reach the firm's goals in 1982. In my view, we had a fine--but in some ways flawed--year in 1981. In many respects our reported financial results were, I believe, better than our actual performance.

We certainly had the luxury of high interest profits, profits which may be importantly lower in the year ahead. Our corporate goal is to earn in excess of $100,000,000. To achieve this will require a mighty effort and mighty accomplishments on your part, on the part of your branch managers, and on the part of everyone at Battery Park.

Together we can do it, but it will take quite some push. Let's get started.

George L. Ball

GLB:pz

cc: R. Fomon

EFHutton
INTER-OFFICE MEMORANDUM

TO Regional Vice Presidents
Regional Sales Managers
Branch Office Managers

FROM George L. Ball

DATE August 5, 1982

SUBJECT Operating Profit

High fences make good neighbors and high interest profits create good margins. However, interest levels are a two-edged lord; they can go down as well as up. When they do, the impact on the bottom line of many branches will be a grave one.

An outstanding branch should have operating margins of at least 10% (and preferably 12%). These, coupled with net interest income, can provide a splendid pool of profits even when interest spreads narrow. However, too many offices today are generating operating margins far skinnier than the 10% or more desired.

If your office is one of these, a sound dose of gross improvement or cost control is prescribed.

George L. Ball

GLB:pz

EF Hutton
INTER-OFFICE MEMORANDUM

TO Regional Vice Presidents and Regional Sales Managers

FROM George Ball

DATE April 27, 1981

SUBJECT Region of the Month — March

The New England region was the top region during the marvelous month of March. The closest contenders were the Atlantic, Pacific North, and Southeast regions.

An examination of the P&L indicates that those offices paying particularly close attention to their interest profit tended to be the standouts, although we must never neglect or downplay our normal "operating" business.

Along the way each region and/or each manager would be well advised to contact Tom Morley and his associates for assistance in maximizing the net interest income from their activities. Tom knows a number of ways in which to help branches derive a proper share of the profit from the funds which flow to and through them.

George Ball

GLB/jdv

Mr. Morrison. These memos, have you had a chance to look at them?

Mr. Dippel. I need a minute more. Just 1 more minute, please. We, I have looked at the memos.

Mr. Morrison. Well, do you remember receiving those memos back in 81?

Mr. Dippel. George Ball sent hundreds of memos. These memos I am certain I looked at at the time. I don't specifically remember receiving them 4 years ago, but I acknowledge that this would be a type of memo that he sent and probably so.

Mr. Morrison. When you say that George Ball sent hundreds of memos would it be fair to say that he took a real hands-on view of what happens happening in the branches?

Mr. Dippel. I characterize him as being a prolific memo writer.

Mr. Morrison. Does that mean there was some substance to the memos or subject matter?

Mr. Dippel. He communicated often by memo and was, yes, a hands-on manager in my opinion.

Mr. Morrison. One usually thinks of someone of that sort as being informed about what was going on that would give rise to his expressing opinions about it.

Mr. Dippel. I would have to characterize George that way, yes.

Mr. Morrison. As you look at these memos now, you had already described being informed that your region was, as you put it, the cellar as far as generating interest income.

Mr. Dippel. Yes.

Mr. Morrison. Did you take these memos in that context as critical of that situation?

Mr. Dippel. Well, I think when you are president of a company it is your job to point out underachievement. I would certainly say that it was properly critical and certainly something we should in the region look at ourselves.

Mr. Morrison. Did you feel under pressure to change that circumstance?

Mr. Dippel. We are constantly under pressure. It is a very competitive environment and we are a very competitive firm, so no more competitive than any other situation where we might be in the cellar.

Mr. Morrison. You are talking about competition here within the firm though?

Mr. Dippel. In that case, no.

Mr. Morrison. There is no case that you were competing in the marketplace, just that your part of the operation was not generating as much income as other parts?

Mr. Dippel. I saw no comparisons with the industry. It was solely comparison within Hutton.

Mr. Morrison. Did you feel as a result of those memos that it was part of your job to improve the income interest performance in your region?

Mr. Dippel. Yes; in addition to that, Mr. Latshaw, our regional vice president specifically assigned the task to me of promoting if that is the word, or motivating, encouraging the improvement of interest income in our region, as this would not be in the normal parameters of my duties. So this became a special project to me in June 1981.

Mr. **Morrison**. What did you do to implement that project?

Mr. **Dippel**. To me it was a matter of analyzing the components, and it kind of went this way. Interest income was made up of various flows. Only one small portion of it was in banking as I call it. The others were in adding margin accounts, creating additional AMA accounts, which is our cash management account.

I had a strategy that I thought was very good and that was to attract professional short sellers to the region, because a short selling technique provides a deposit which at 20 percent interest rates, and that is what we were talking about then, 20 percent interest rates would yield an enormous amount of interest income.

So it was about a seven-prong attack on interest income. One part of it certainly was banking.

Mr. **Morrison**. And in your focus on the banking portion, did you—what steps did you take to improve the interest income from that portion of the situation?

Mr. **Dippel**. Mr. Ball suggested that Mr. Morley could be of great help to us in that area. So we enlisted Mr. Morley to be our ally in helping us in this area.

Mr. **Morrison**. And that was I guess in the April 27 memo that we have made reference to that it says Tom knows a number of ways in which to help branches derive a proper share of the profit from the funds that flow to and through them?

Mr. **Dippel**. He certainly referred to it in that instance. However, he also introduced him to our branch managers in June 1981 at that meeting in New York. So certainly George Ball was an endorser and a sponsor of Tom Morley as a person who could help peeple with their interest.

Mr. **Morrison**. Now was Tom Morley's help limited to this banking portion of the activity? Is that all——

Mr. **Dippel**. That is a very interesting question. For 2 months I thought his scope was the entire interest income, but to answer the question, Mr. Morley's scope I found out was just banking, period.

Mr. **Morrison**. Was that a scope that was assigned by Mr. Ball or by the company or did that seem to be just because that is where Mr. Morley had found his niche?

Mr. **Dippel**. I know. I know him as—in retrospect as a mobilizer and his duties in my mind are those of banking, period.

Mr. **Morrison**. Did you receive any encouragement or referral to anyone else in the corporate structure to help you with these other projects to improve interest income or was it just banking?

Mr. **Dippel**. No; the other projects were sales related, increasing margin accounts, my coregional sales manager, Gary Irish, took that project, I worked on the short sales. They tied in with the normal course of business. Only the banking was brand new to us on the sales side.

Mr. **Morrison**. So in other words, you said that the banking portion was really minor, but it was only a part of what one normally would expect to earn interest in?

Mr. **Dippel**. Yes.

Mr. Morrison. Yet that was the area in which you were being stimulated by the corporate headquarters as opposed to what you were doing on your own in your normal regional sales activities?

Mr. Dippel. I didn't see it that way. So, my view of it, we were in 20 percent interest rates, which is really—it is a time when you could make a great deal of money in any endeavor that has to do with cash flow.

Mr. Morrison. And lose a lot of money if you are in a debit position?

Mr. Dippel. That is right. Therefore, I believe that the effort that I felt and that we all felt was to optimize our interest income period. At least that is the way I viewed it.

Mr. Morrison. I understand where you are coming from when you describe it but you have told me that essentially you were singled out by Mr. Ball from the top of your company to say you are not doing your job on interest income, and we have a way to help. You had a range of suggestions for yourself that you developed?

Mr. Dippel. Yes.

Mr. Morrison. Out of your knowledge of the business as to how to generate more interest income but all that they had to offer and the thing that was offered outside your experience was in the banking area and was in a new approach to cash management and that came to you, you didn't think that up and decide to do it on your own, somebody told you this was a thing to do.

Mr. Dippel. Yes.

Mr. Morrison. So what you did in that area was driven by what you were structured to do by Mr. Morley?

Mr. Dippel. Yes.

Mr. Morrison. I would like now to call on the gentleman from Florida.

Mr. McCollum. Mr. Dippel, thank you for coming and sitting a long time today.

I understand from listening to the questions that the chairman has been asking that you were kind of in the hot seat with respect to getting up that interest profitability and so on from Mr. Ball's memos, Mr. Morley's encouragement, and so on, and I assume that you had conversations and whatnot with branch managers from time to time about this as a result of that personally, did you not?

Mr. Dippel. Yes.

Mr. McCollum. And in those conversations did you give the impression intentionally that you were anxious to get relief in this area?

Mr. Dippel. I would never characterize that or speak that way to our managers as though it were a personal pressure. I feel that when we are underachieving that we should all work as a team and at least come up to the firm average.

But we knew that we needed—I self-reflected the thought that we were in the cellar and needed to come up.

Mr. McCollum. Were you privy to comparative figures for other regions on the area of income and interest and so on, did you see the interest other regions had that you were being compared to?

Mr. Dippel. Yes.

Mr. McCollum. Was there a significant difference in other areas, some much greater than yours, some closer to you?

Mr. Dippel. Memory says we were last by 20 percent. The range in June 1981 was our 14 percent, tops was 19 percent, quite a lot.

Mr. McCollum. Did it surprise you that some might be 19 percent? Did that seem pretty hard to achieve? Obviously, you were in the cellar but did it ever occur to you that maybe this was pretty unusual, they must be doing something different than we are and I am not exactly sure what it is.

Mr. Dippel. Yes; I certainly—I didn't have a frame of reference to know if it was too high, but I certainly wanted to find out what the differences were.

Mr. McCollum. Did you talk to some of the regional managers that had this high amount to see what they were doing on their own without going to Mr. Morley?

Mr. Dippel. I focused on Mr. Morley because he had the information.

Mr. McCollum. You didn't talk directly with the regional manager that had 19 percent?

Mr. Dippel. I might have but for some reason my memory says that it wasn't fruitful and I can't pursue it.

Mr. McCollum. Did Mr. Morley ever tell you how to anticipate deposits when making your daily drawdown?

Mr. Dippel. On the matter of cash management and banking, to give a perspective, in my career, and this is prior to the spring of this year, I might add, in my career I think it would be a heavy statement to say that I have spent 2 hours of time in cash management. To say around the drawdown system, I don't know the drawdown system. However, I will comment on your question.

Mr. Morley visited the Kansas City office and spent 1 day with our cashier doing whatever money mobilizers do with cashiers, but in that meeting he mentioned the—some ideas that he had on—my question was, look, there is a formula I guess, so there is some kind of formula, why not just print the formula and give it to everybody. Why do we need meetings?

Well, the answer was that there are—I don't remember conversations specifically. For instance, I probably have 100 conversations a day and that is 100,000 a year, but I remember big picture and broad messages, and the message I got from Mr. Morley in that instance was that, yes, there is a formula but there are some ways of anticipating extraordinary receipts, those that you could identify, and perhaps treat those differently, and he—the one that I remember specifically is the DVP anticipation.

Mr. McCollum. What does DVP stand for?

Mr. Dippel. Excuse me. We are getting into our terminology. I agree I think we ought to change a lot of it. DVP means different reverse payment. This would be an instance where securities or bonds were delivered to Hutton or we were delivering them and the payment was made at the bank against payment.

Mr. McCollum. And he did discuss that aspect with your cashier in your presence?

Mr. Dippel. He did and with me because I wanted things that we could do to—some variables to improve. Certainly we have the regular formula or whatever it is, but I wanted things that we could do to be better and that was one area that he mentioned.

Mr. McCollum. He mentioned others, too, besides that?

Mr. Dippel. It seemed to me that it boiled down—this is memory of 4 years ago—it boiled down to identifying large receipts that might be coming in. But on the DVP, I understood what he meant. I think I called around a little to see if I could find some DVP's.

Mr. McCollum. Did you?

Mr. Dippel. I believe I did, but I don't believe we ever did anything with the system. Betty Smith, our regional cashier, mentioned it to me a couple of times, but really she is such a procedurely oriented person, she goes by the letter and unless there was something in writing specifically she wouldn't have done it. I believe I tried to find some DVP's we talked about it and never did anything.

Mr. McCollum. Within 6 months or a year from the time that Mr. Morley came and met with you and you were on the bottom rung of this at 14 percent, did the region improve in the figures?

Mr. Dippel. The first month we weren't much better, but there was a little improvement and then to kind of broaden the story quickly, it was about a 3-month program, because when the first figures came out, and the only figures that I would see in my role were the profit and loss statements, which has a separate item for interest income.

That is the only document I ever saw. So at that time we did not have any breakdown of the components.

Mr. McCollum. But the interest income did go up next time you saw it.

Mr. Dippel. Yes; it went up to about 15 percent for August. We started in July, August, yes.

Mr. McCollum. Did it continue to improve after that?

Mr. Dippel. Yes.

Mr. McCollum. Was it dramatic or just what you had hoped for?

Mr. Dippel. I don't know how to evaluate it. If we wanted to be No. 1, it wasn't enough to be that. It brought us up overall into the midrange.

Mr. McCollum. You were reasonably satisfied with that?

Mr. Dippel. I wouldn't be satisfied but at least——

Mr. McCollum. What about Betty Smith, she, as cashier—you would say after Mr. Morley met with her, this is pretty tough stuff to do, I don't know how those guys are getting 19 percent?

Mr. Dippel. I don't know if she felt the pressure. For 31 years, she does it by the book and whatever it is, it is. I think she certainly wanted to help, but I don't think she is really concerned. She never saw the percentages.

Mr. McCollum. There is the impression in all of this throughout the hearings that we have held that management level, Mr. Morley and above, didn't really know some of these aggressive practices that were going on to meet the goals that were sated and that in fact whatever was being done was being done at a regional or branch level and, gee, we just didn't understand that was happening.

Did you get that impression? Was your imprression the other way around, that they were encouraging whatever was going on?

Mr. Dippel. I didn't think of it one way or the other. We were always as a team striving to be the best, and I never really thought of it as against, well, there is somebody up or over here that doesn't know and it is all happening down here. That characterization I don't recognize.

Mr. McCOLLUM. Mr. Chairman, I have probably exceeded my 5 minutes. I know that the chairman just resumed the Chair again but I have, quite frankly, asked about all the questions of Mr. Dippel that I had to ask.

We have spent quite a bit of time exploring with him but I hate to drop it back in your lap in midstream.

Mr. HUGHES. I appreciate the gentleman. I apologize for the break, but unfortunately I had another commitment over on the Senate side.

Mr. Dippel, good afternoon.

Mr. DIPPEL. Good afternoon, Mr. Chairman.

Mr. HUGHES. Welcome here today, Mr. Dippel.

Mr. Dippel, I am going to ask you to examine an E.F. Hutton memo from apparently yourself to a Bob, dated July 10, 1985, which has some attachments to it, one a memo from George Ball, Jr. III, which without objection will be made a part of the record, and ask if you can tell us what you know about this memo and the attachments.

[The memorandum follows:]

EFHutton

EF Hutton & Company Inc
920 Baltimore
Kansas City, MO 64105
Tel. (816) 283-7200
Central Region

Memo from* Ernest C. Dippel-*Regional Vice President

July 10, 1985

Bob,

As you know, I got these from Ralph Williams in the last couple of weeks--- not from my file.

EF Hutton

EF Hutton & Company Inc
One Battery Park Plaza
New York, New York 10004
Tel. (212) 742-8744

Memo from George L. Ball

June 3, 1981

To: Regional Vice Presidents
Regional Sales Managers
Branch Office Managers

A point well worth remembering, and acting on.

George
GLB:ps

EFHutto
INTER-OFFICE MEMORANDU

TO Tom Morley
FROM Tom Lillis
DATE May 12, 1981
SUBJECT Interest

In support of one of my memos of the past on the importance of a good branch cashier and the relative worth of a branch cashier to an account executive, I give the following examples:

For the months of January and February, 1981 (and many months before) a certain branch in our retail system had been earning a consistent $30,000 per month in interest just from overdrafting of the bank account. At the beginning of March, 1981, the branch manager changed cashiers and for the months of March and April, 1981 the same branch earned less than $10,000 per month by overdrafting the bank account. In two months the branch lost $40,000 of location profit and the branch manager lost $4,000 of additional bonus.

Therefore, I repeat "A good branch cashier is worth as much as an A.E.". Between us we need a program to accelerate branch and region awareness of the opportunities for interest profits.

6/2

Tom

TL/amm

cc: M. Castellano
P. Hines ✓
L. Milazzo

Mr. **Hughes**. Take your time and go through the memo to yourself and the memo from George Ball as well as the memo from Tom Willis to Tom Morley.

Mr. **Dippel**. Yes, I know this memo.

Mr. **Hughes**. Have you seen this memo before?

Mr. **Dippel**. Yes.

Mr. **Hughes**. I presume that the memo dated July 10, 1985 is from yourself?

Mr. **Dippel**. Yes, it is.

Mr. **Hughes**. Who is Bob?

Mr. **Dippel**. Bob Brunton, legal counsel, E.F. Hutton.

Mr. **Hughes**. Were the attachments also part of the original memo? Are they attached to your memo of July 10?

Mr. **Dippel**. Yes. I sent Bob Brunton these memos, these two sheets on July 10.

Mr. **Hughes**. Who is Ralph Williams?

Mr. **Dippel**. Ralph Williams is the regional vice president of the southeast region from Atlanta, GA.

Mr. **Hughes**. What was the purpose of sending out this memo, what were you in fact saying?

Mr. **Dippel**. Mr. Williams had supplied me with that memo, a memo that he had found, and I was simply sending it to Bob Brunton in the production of records, but explaining that it didn't come from me, that it came from Ralph Williams.

Bob Brunton was the collector of documents for the subcommittee. I just wanted to be—I was being very, very cautious to get all documents, even though this did not come out of my file. It is a document I had received from Mr. Williams.

Mr. **Hughes**. What in your opinion is the significance of the memo that you attached to the memo?

Mr. **Dippel**. It was a——

Mr. **Hughes**. Of the memo from Tom Willis to Tom Morley of May 12, 1981?

Mr. **Dippel**. It was a memo to Mr. Morley from Mr. Willis giving an example of the difference between a good branch cashier and a new branch cashier.

Mr. **Hughes**. In essence, what it is saying is that for the most of January and February 1981 a certain branch in our retail system had been earning a consistent $30,000 per month in interest just from overdrafting of a bank account and for the months of March and April 1981 the same branch earned less than $10,000 a month by overdrafting and points up how much money we lose when we are not aggressively overdrafting, isn't that what it says?

Mr. **Dippel**. Yes.

Mr. **Hughes**. No question about that, is there?

Mr. **Dippel**. No.

Mr. **Hughes**. Take a look at a memo which without objection I will make a part of the record of March 30, 1981 from George Ball to Bob Witt and ask if you have ever seen that memo?

[The memorandum follows:]

E.F.Hutton
INTER-OFFICE MEMORANDUM

TO Bob Witt
FROM George Ball
DATE April 30, 1981
SUBJECT March Performance

10 :" = 363

Your region stood first in March. Noted below are my perceptions of the performance of each of your offices for the month:

Excellent 4	Good 3
Burlington	Albany
Burlington — Executive Park	Boston
Glens Falls	4 Chestnut Hill
1 Hartford	Providence 12
Manchester 38	
Portland	
Salem	
Fair	Poor

The region had a superb month. How did Rick manage to generate a 48% profit margin? Was it largely legal interest profit?

George Ball

GLB/jdv
cc: Paul Crabtree

Mr. **Hughes**. First of all, who is Bob Witt?

Mr. **Dippel**. Bob Witt is an executive vice president and national sales manager. At the time he was the regional vice president of the northeast region.

Mr. **Hughes**. Have you seen this particular memo before?

Mr. **Dippel**. No.

Mr. **Hughes**. Is this typical of the memos that were coming out from George Ball, no?

Mr. **Dippel**. Yes.

Mr. **Hughes**. I bring your attention to the fact that in this particular memo, which I find very interesting, he talks in terms of March performance—I presume March 1981, the month before the date of this memo. He says, your region was first in March. Notably are my perceptions of the performance of each of your offices for the month—and he has excellent—and he has a number of branches I presume that were excellent, and he has under the category G four branches, including Albany, and then no branches under fair or poor.

Is that how you would read that memo?

Mr. **Dippel**. Yes.

Mr. **Hughes**. What he is saying is that in this particular region we have a number of excellent and some good branches, and then he says the region had a superb month.

How did Rick manage to generate a 48-percent profit margin? Was it largely legal interest profit? Had you heard the term "legal interest profit" used before?

Mr. **Dippel**. No.

Mr. **Hughes**. Do you have any idea what that will mean?

Mr. **Dippel**. No.

Mr. **Hughes**. As opposed to illegal interest profit?

Mr. **Dippel**. I think it must be a misprint. I mean, I don't know that, but I don't have a—I cannot characterize legal interest profit.

Mr. **Hughes**. I also asked the staff to show you several other memos—one from George Ball to John Latshaw dated October 15, 1981.

Can you identify John Latshaw first?

Mr. **Dippel**. Yes. John Latshaw is a regional vice president. To clarify, we are coregional vice presidents of the central region.

Mr. **Hughes**. What region?

Mr. **Dippel**. The central region.

Mr. **Hughes**. That is dated October 15, 1981.

Also, a memo to Lee Broad from Gary D. Irish of September 8, 1981, which I will ask the staff to provide to you.

Again, are these typical of the memos that were coming out from George Ball or to George Ball and from other regional vice presidents and people at headquarters, comparing the regions and the interest profits and other profits from the various branch offices?

Mr. **Dippel**. There was a great deal of focus on interest profits during that period, because of the approximately 20 percent interest rate. So, my answer would be yes, there were a number of memos.

Mr. **Hughes**. The same thing with the memo of September 8 from Gary D. Irish. Can you identify Gary D. Irish for us?

Mr. DIPPEL. Yes. At that time, Gary Irish and I were coregional sales managers. He was my peer—of the central region, yes.

Mr. HUGHES. Of the central region?

Mr. DIPPEL. Yes.

Mr. HUGHES. How about Lee Broad?

Mr. DIPPEL. Lee Broad was a corporate development executive. That is an analyst, an individual who deals in the analysis of E.F. Hutton's statistics.

Mr. HUGHES. Without objection, I am going to put these in the record.

[The information follows:]

Inter-Office Memorandum FILE **EFHutton**

TO George Ball
FROM John Latshaw
SUBJECT Cost Control and Interest
DATE October 15, 1981

Hope the discussion at the Planning Meeting effectively showed our progress in Indirect Costs and Interest.

The interest situation is difficult with our low agency and high commodity gross, but August and September indicate enormous success in the overdrafting department.

We will not let up until we really excel in both areas.

Best personal regards

FC 14A (Rev. 11/80)

Dick

John's writing—
Poor interest profits and rather high ICs are crippling the region's bottom line. Both need concerted attention
Gerry

CENTRAL REGION
COST CONTROL REPORT
SIX MONTHS ENDED JUNE 30, 1981
($ Per AE)

	6 MOS. 1980		6 MOS. 1981		INCREASE/(DECREASE		BETTER
	FIRM	REGION	FIRM	REGION	FIRM	REGION	(WORSE)
ROSS REVENUE	67196	66623	74317	74463	10.6%	11.8%	1.2%
DIRECT COSTS	25528	26098	29300	29247	14.8%	12.1%	2.7%
RECT COSTS %	38.0%	39.2%	39.4%	39.3%	1.4%	0.1%	1.3%
NDIRECT COSTS (See below)	15839	17314	17966	18845	13.4%	8.8%	4.6%
ET INTEREST	8357	7285	11960	9727	43.1%	33.5%	(9.6%)
ET PROFIT	15851	11631	19110 →	15951	20.6%	37.1%	16.5%
ET PROFIT %	23.6%	17.5%	25.7%	21.4%	2.1%	3.9%	1.8%
CATION PROFIT %	50.9%	45.8%	52.5%	48.5%	1.6%	2.7%	1.1%

still high

good

John Latshaw--
Poor interest profits and rather high ICs are crippling the region's bottom line. Both need concerted attention.

George
CLB:pz

NDIRECT COSTS							
Salaries, Benefits & Payroll Taxes	4417	4859	5393	5514	22.1%	13.5%	8.6%
Communications	4071	4627	4571	4787	12.3%	3.5%	8.8%
Bad Debts & Errors	1685	1286	953	1558	(43.4%)	21.2%	(64.6%)
Purchased Service & Supply	2108	2477	3057	2895	45.0%	16.9%	28.1%
Occupancy & Equipment	2202	2323	2435	2463	10.6%	6.0%	4.6%
Other	1356	1742	1557	1628	14.8%	(6.5%)	21.3%
Total	15839	17314	17966	18845	13.4%	8.8%	4.6%

What should we do about this?
Pls give some thought & let's take necessary action.
Prepare a letter

EFHutton
INTER-OFFICE MEMORANDUM

TO Lee Broad
FROM Gary D. Irish - CKC
DATE September 8, 1981
SUBJECT

Dear Lee:

Please find enclosed the original of your Net Interest Income study which you gave Ernie and I the opportunity to look at.

Many thanks for this and all of your other help and the opportunity to be with Margaret and yourself.

Be talking to you and seeing you again very soon.

Warmest personal regards,

Gary D. Irish
Regional Sales Manager

GDI:am
Enclosure
cc: Ernie Dippel

EFHutton
INTER-OFFICE MEMORANDUM

TO CENTRAL REGION BRANCH MANAGERS
FROM ERNIE DIPPEL
DATE SEPTEMBER 24, 1981
SUBJECT INTEREST INCOME

OFFICE	AMOUNT	YEAR-TO-DATE % OF GROSS	RANK	AMOUNT	AUGUST % OF GROSS	RANK
AVR	293M	25.5	1	98M	70.7	1
BAL	195	14.0	8	27	15.5	11
BET	172	17.8	4	40	28.1	3
SLO	77	6.0	17	5	5.1	17
DES	96	11.4	13	19	19.7	8
CKC	616	15.3	5	76	17.0	10
KNX	104	14.2	7	7	7.8	16
LIN	50	7.9	16	10	11.3	15
LKY	256	11.1	14	39	14.6	12
NMS	267	12.6	11	32	12.8	14
NVL	73	13.8	9	15	23.9	5
NFK	358	19.7	3	54	25.9	4
OMH	96	12.2	12	15	20.8	7
STL	438	11.1	14	73	17.5	9
WDC	597	14.4	6	80	14.6	12
WJC	284	13.5	10	53	28.2	2
WCH	333	20.7	2	39	20.9	6
TOTAL REGION	4,312	14.2		689	19.6	
TOTAL FIRM	57,827	16.6		7,749	18.6	
HIGH REGION SOUTH CENTRAL		18.7	SOUTH CENTRAL		19.7	
LOW REGION CENTRAL		14.2	NEW ENGLAND		16.7	

FC 141REV. 9/79

INTEREST INCOME BY REGION

AUGUST / YEAR-TO-DATE

REGION	AMOUNT	YEAR-TO-DATE % OF GROSS	AMOUNT	AUGUST % OF GROSS
ATLANTIC	12,785	16.4	17,177	18.1
CENTRAL	4,312	14.2	6,891	19.6
MIDWEST	5,560	14.4	7,287	16.8
MOUNTAIN	5,126	17.8	7,459	18.8
NEW ENGLAND	3,791	15.7	4,747	16.7
PACIFIC NORTH	5,374	17.9	6,933	19.6
PACIFIC SOUTH	7,070	17.9	9,527	19.3
SOUTH CENTRAL	6,091	18.7	8,049	18.8
SOUTH EAST	7,715	16.6	9,420	19.7
	57,824	16.6	7,749	18.6

Mr. HUGHES. Looking at the September 24, 1981 memo, it has also analysis from yourself dated September 24, 1981. I presume that you prepared that?

Mr. DIPPEL. Yes, I did.

Mr. HUGHES. I gather the first office, the AVR office—is that the Alexandria office?

Mr. DIPPEL. That is correct.

Mr. HUGHES. That is the code name?

Mr. DIPPEL. Yes, that is our wire symbol for each office.

Mr. HUGHES. I take it that that office as of September 24, 1981, on the subject of interest income, was the number one office having grossed something like 70.7 percent of their profits from interest income?

Mr. DIPPEL. Yes.

Mr. HUGHES. Is that an accurate reading of that?

Mr. DIPPEL. Yes.

Well, their interest income—it wasn't 70 percent of their interest income. It was 70 percent of gross. That is correct, yes—excuse me. Yes.

Mr. HUGHES. So that means that 70 percent of the income of that particular office—and I presume it is for August 1981——

Mr. DIPPEL. Yes, it is.

Mr. HUGHES [continuing]. The month before—came from interest income?

Mr. DIPPEL. Well, 70 percent of the——

Mr. HUGHES. Of the gross.

Mr. DIPPEL. Yes, the gross.

Interest income represented an amount equal to 70 percent of the gross.

Mr. HUGHES. That is astounding, isn't it?

Mr. DIPPEL. Yes.

Mr. HUGHES. What do you think an office that was—is this Knoxville down here, about seven down, KNX?

Mr. DIPPEL. That is Knoxville, yes, sir.

Mr. HUGHES. What was that telling Knoxville, which had a 7.8 percent?

Mr. DIPPEL. Well, it would tell them that they didn't do well in relation to the average. But many months, taking this in perspective, there would be some errors in P&L's. I think you have to look at their year to date at 14 percent to see how they normally do without any exaggerations of the 1 month figure.

Mr. HUGHES. Who directed that this particular analysis be sent out to the various offices?

Mr. DIPPEL. This was either the first or the second of my two or three monthly rankings to motivate interest income production in the central region.

I don't know if you were in the room when we went through that. Would you like me to go through it again?

Mr. HUGHES. No, that won't be necessary.

Mr. DIPPEL. It is a promotional piece. It was my idea. As the individual assigned to motivating income, it was my way of ranking among the offices.

Mr. HUGHES. Did you do this on your own, or did somebody direct you in the company to do that?

Mr. **Dippel**. No, I took it right off the P&L, a 10-minute job.

Mr. **Hughes**. But the idea of sending out this analysis was your idea?

Mr. **Dippel**. Yes, because that is the way I manage. In all the areas of sales, we rank. I am a ranker.

Mr. **Hughes**. Well, there is no question but that this was intended to put some pressure——

Mr. **Dippel**. Absolutely.

Mr. **Hughes** [continuing]. On the various branches to maximize their interest income.

Mr. **Dippel**. That is correct.

Mr. **Hughes**. And we have heard testimony that if, in fact, these various branches wanted to know how to maximize their interest income, they were to contact certain parties within E.F. Hutton; isn't that so?

Mr. **Dippel**. Yes.

Mr. **Hughes**. And who was that individual?

Mr. **Dippel**. Again, in the prior testimony, Tom Morley was the individual who we enlisted, at the suggestion of George Ball, to help us with the banking aspect of interest income.

Mr. **Hughes**. Did you realize that many of these branches, such as the Alexandria branch, were actually very aggressively overdrafting? For a $70,000 deposit, they were drawing down as much as $8 million or $9 million?

Mr. **Dippel**. I didn't know that characterization. I did know—when you are looking at me, you are looking at the individual who was assigned to motivate and to inspire the managers to get their interest income up. But—and I was not the individual who monitored and was in charge of banking. However, I went the extra mile. I sent all of these numbers back to Tom Morley to let him know how we are doing, because first I had no idea whether the 70 percent had anything to do with banking.

Mr. **Hughes**. Well, how did you figure that a branch office like Alexandria could generate 70 percent of their gross in a given month in just interest income? How did you think they were doing it?

Mr. **Dippel**. Well, first, the interest income is a separate figure. They have their gross income. And then this interest income figure is a comparison against that. It might have been 200 percent.

Now, the way it could have been 200 percent is if an office became heavily involved in my professional short selling program. I had a plan where we would attract professional short sellers to E.F. Hutton, reduce their commission rates, short sale a credit balance on which we would earn 20 percent; $5 million in short sales would be $1 million a year. So banking isn't the only area of opportunity.

Mr. **Hughes**. That is not the point I am making. My point is, here we have a relatively new office——

Mr. **Dippel**. Yes.

Mr. **Hughes** [continuing]. In Alexandria, and 70.7 percent of their gross for the month of August 1981 came from interest income.

Isn't that astounding?

Mr. **Dippel**. It is above average.

Mr. **Hughes**. That probably is the understatement of the day. I have heard a lot of understatements.

Mr. **Dippel**. But it certainly was, and that is why I investigated it.

Mr. **Hughes**. Did you investigate it, or did you send it out and say to all the offices, "Look what these guys are doing"?

Mr. **Dippel**. I did both.

Mr. **Hughes**. I don't know how you did the other, because I don't see anything else that suggests you investigated.

What did you investigate?

Mr. **Dippel**. I went back to our money mobilizer, Mr. Morley, and asked him if this could have been an area that he had helped us with. He had done so well I wanted him to show us how to do it in other areas.

Mr. **Hughes**. What did you find out when you investigated?

Mr. **Dippel**. He gave me a message. He said he had found that there was an area of great availability in Alexandria, a great pocket of availability. And I said, "Well, can we count on this type of success from here on, and can we do it other places?"

And he said, "No, it is a special pocket of availability." He said, "Give me 3 months; I need to run it 3 months for me to come back to you."

So, that was my investigation of that 70 percent.

Mr. **Hughes**. Is that a term of art, special pocket of availability?

Mr. **Dippel**. It is my characterization of availability.

Mr. **Hughes**. Did you ever find out how the Alexandria office ever acquired that much in interest income? Your job was to try to maximize interest income. Here you have an office that is far and above all the others.

Did you ever determine how the office in Alexandria acquired that much?

Mr. **Dippel**. That was my first investigation, because I couldn't apply it elsewhere and I felt that I had the man that the president of the firm had referred to us to help us, Mr. Morley, and that he was on that end of it, that whatever he said is great.

Mr. **Hughes**. Did he ever tell you what they were doing right?

Mr. **Dippel**. I am not into details.

Mr. **Hughes**. You weren't into details?

Mr. **Dippel**. No.

Mr. **Hughes**. Here you have an office that you are very proud of. You are really putting out an analysis that shows that you have an office that is way out in orbit when it comes to interest income. And your job is to maximize interest income?

Mr. **Dippel**. That is correct.

Mr. **Hughes**. And part of your job is to try to find out what techniques are being used.

Mr. **Dippel**. Yes.

Mr. **Hughes**. You never found out what the techniques were?

Mr. **Dippel**. I wouldn't have done anything with techniques. Mr. Morley was the specialist whom I relied upon to develop that for us. And he, as a team with the regional operations group, would carry that ball; that is correct.

I don't do cashiering. I delegate that.

Mr. **Hughes**. You would have us believe that your curiosity never got the best of you.

Mr. **Dippel**. It did, and I reflected it to Mr. Morley and got the answer, and that ended it right there.

Mr. **Hughes**. What was the answer?

Mr. **Dippel**. There was a pocket of availability.

Mr. **Hughes**. Do you know what he meant by that?

Mr. **Dippel**. No.

Mr. **Hughes**. You didn't ask what he meant?

Mr. **Dippel**. No.

Mr. **Hughes**. You weren't curious about what he meant by "pocket of availability"?

Mr. **Dippel**. No.

Mr. **Hughes**. I find that incredible.

Just about 3 months later, the Alexandria branch overdrew twice the August figure. Now, they really were catching on.

Did you become aware of that fact?

Mr. **Dippel**. What date?

Mr. **Hughes**. Three months, November 1981.

Mr. **Dippel**. In November, there is a story to tell.

Mr. **Hughes**. Let's hear it.

Mr. **Dippel**. You want to hear it?

Mr. **Hughes**. Yes.

Mr. **Dippel**. You may have—let's go right into it. Do you have the Commerce Bank letter?

Mr. **Hughes**. Yes.

Mr. **Dippel**. Shall we just start with that?

I could tell it without it——

Mr. **Hughes**. I thought maybe you would only tell the story if we had a letter.

I wonder if the clerk might just furnish to the witness a copy of the letter of June 26, 1985 from Thomas Curnin, an attorney with Cahill Gordon & Reindel, to Ernie—I presume to yourself——

Mr. **Dippel**. Yes.

Mr. **Hughes** [continuing]. With an attachment dated November 3, 1981 to Mr. John Latshaw from David W. Kemper, senior executive vice president.

Mr. **Dippel**. Correct.

Mr. **Hughes**. Without objection, the document will be made a part of the record.

[The information follows:]

CAHILL GORDON & REINDEL
EIGHTY PINE STREET
NEW YORK, N.Y. 10005

FLOYD ABRAMS
ROGER ANDRUS
HENRY G. BISGAIER
CARL M. BORNMANN
P. KEVIN CASTEL
WALTER C. CLIFF, P.C.
BENJAMIN J. COHEN
JOSEPH P. CONWAY
MARSHALL COX
THOMAS F. CURNIN
W. LESLIE DUFFY
RAYMOND L. FALLS, JR.
PATRICIA FARREN
BART FRIEDMAN
CIRO A. GAMBONI
CHARLES A. GILMAN
STEPHEN A. GREENE
ROBERT M. HALLMAN
EDWARD A. HANSEN
WILLIAM E. HEGARTY
DAVID R. HYDE
THOMAS R. JONES
ALLEN S. JOSLYN
THOMAS J. KAVALER
LAWRENCE A. KOBRIN
IMMANUEL KOHN
WILLIAM T. LIFLAND
MICHAEL MACRIS
JONATHAN I. MARK

DENIS McINERNEY, P.C.
RAND McQUINN *
GERARD M. MEISTRELL
ROGER MELTZER
CLIFFORD L. MICHEL
JOHN P. MITCHELL
MATHIAS E. MONE
HUGH P. MORRISON, JR. *
DONALD J. MULVIHILL
KENNETH W. ORCE
CHARLES PLATTO
ROY L. REGOZIN
DEAN RINGEL
THORN ROSENTHAL
IRWIN SCHNEIDERMAN, P.C.
W. RICHARD SCHUMACHER
HOWARD G. SLOANE
LAURENCE T. SORKIN
LEONARD A. SPIVAK
GERALD S. TANENBAUM
DUDLEY B. TENNEY, P.C.
MICHAEL P. TIERNEY
ROBERT USADI
JOHN R. VAUGHAN
GEORGE WAILAND
RALPH O. WINGER
GARY W. WOLF
JOHN R. YOUNG

[illegible]
[illegible]
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JOHN J. STANTON, JR.
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*ADMITTED D.C. ONLY
**ALSO ADMITTED [illegible]
***ADMITTED FRANCE ONLY

WRITER'S DIRECT NUMBER
(212) 701-3609

June 26, 1985

Re: Hutton - F Matter

Dear Ernie:

As you requested, enclosed please find a copy of the November 3, 1981 letter from David W. Kemper of Texas Commerce Bank to John Latshaw.

Sincerely,

Tom Curnin

Thomas F. Curnin

Mr. Ernest Dippel
E.F. Hutton & Company Inc.
920 Baltimore
Kansas City, MO 64105

VIA FEDERAL EXPRESS

[Enclosure]

November 3, 1981

Mr. John Latshaw
Executive Vice President
E. F. Hutton & Company, Inc.
920 Baltimore
Kansas City, Missouri 64105

Dear John:

We have incurred a loss totaling $210,310.45 on the E. F. Hutton account relationship for the period from January through October of this year. This deficit is detailed as follows:

Month	Monthly Loss	Quarterly Loss	Cumulative Loss
January	$ 7,443.54		
February	312.03		$ 7,443.54
March	13,962.53		7,755.57
April	6,792.50	$ 21,718.10 (1st)	21,718.10
May	12,600.01		28,510.60
June	13,536.24		41,110.61
July	13,850.29	32,928.75 (2nd)	54,646.85
August	56,222.41		68,497.14
September	78,911.21		124,719.55
October	6,679.69	148,982.91 (3rd)	203,630.76
			210,310.45

On May 19, 1981, John Owen and Larry Holden called on Tom Morley and were told that our year to date compensation would be analyzed and that the account would be restored to a profitable basis. The losses continued, but we were assured by telephone that the problem would be corrected. Larry Holden again called on your firm on September 15, 1981, and was asked to submit a bill for the third quarter loss and he was told this would be promptly paid. We were requested at that time to use our 1980 profit on the E. F. Hutton accounts to offset the loss for the first six months of 1981. We indicated that our profit last year was quite small in relation to this year's loss and that under no circumstances could it be used to offset any portion of the sizeable deficit incurred in 1981.

We have continued to service the E. F. Hutton accounts despite the substantial losses we have suffered because we have been assured on numerous occasions by representatives of your firm

that the accounts would be restored to a profitable basis. Since this has not happened, we have no alternative but to request payment of $210,310.95 at this time.

We have previously furnished you with the analysis of each months activity with us. As support for the enclosed bill of $210,319.95, attached you will find an additional copy of the detailed information supporting the above review of account losses. We are requesting you reimburse us this $210,310.45 and that you provide us your check in payment of this bill by November 13, 1981. Any losses on the account in future months will be billed by the 5th of the month and we shall expect payment by the 15th.

We appreciate your understanding and cooperation.

Very truly yours,

David W. Kemper
Senior Executive Vice President

DWK/kj
Enclosures

Mr. **Hughes**. Would you explain that to us?

Mr. **Dippel**. In November, Mr. Morley's 3 months were up, so I was curious as to exactly how we were achieving this enormous success.

This matter described in the letter to Mr. Latshaw depicts the billing of E.F. Hutton by the Commerce Bank in Kansas City for the amount of $210,000. Their letter went like this:

> We have incurred a loss totaling $210,000 on the E.F. Hutton account relationship for the period from January through October of this year. This deficit is detailed as follows:

And then it details it each month, and it totals $210,000. I won't bore you with those details.

> On May 19, 1981, John Owen and Larry Holden called on Tom Morley and were told that our year to date compensation would be analyzed and that the account would be restored to a profitable basis. The losses continued, but we were assured by telephone that the problem would be corrected. Larry Holden again called on your firm on September 15, 1981, and was asked to submit a bill for the third quarter loss, and he was told this would be promptly paid.
>
> We were requested at that time to use our 1980 profit on the E.F. Hutton accounts to offset the loss for the first six months of 1981. We indicated that our profit last year was quite small in relation to this year's loss, and that under no circumstances could it be used to offset any portion of the sizeable deficit incurred in 1981.
>
> We have continued to service the E.F. Hutton accounts despite the substantial losses we have suffered, because we have been assured on numerous occasions by representatives of your firm that the accounts would be restored to a profitable basis. Since this has not happened, we have no alternative but to request payment of $210,000.

The last sentence:

> Any losses on the account in future months will be billed by the 5th of the month, and we shall expect payment by the 15th.

Mr. Latshaw happened to be out of the country at the time the bankers arrived at my office in Kansas City, so I handled this. And the net result was my calling Mr. Morley, as Mr. Morley had handled this from A to Z, and I told him of the billing for $210,000, and he replied—he called me back, I believe, and indicated that it should be paid, which we did pay it. But this was the first knowledge that I had—or I think John Latshaw, he will have to make his own testimony—had of this matter.

I don't have the letter at the time. I think they came over in person and just asked for the money. But later in the month, when Mr. Latshaw came back, I discussed it with him. And I said, "Look, John," I said—we said this cash management that we have been doing isn't working. To me, it is an Edsel; it doesn't work. We paid $210,000. I don't think that the region has made that much during this period of increased activity.

In my opinion, personal opinion, without being able to check it, I think we are just transferring money around the system from profit center to profit center; but, in any case, we don't need a letter like this, so let's deemphasize the Morley system.

Now, I feel that this money relates back to Alexandria.

Mr. **Hughes**. This is the first inkling that you had that there was this aggressive overdrafting creating problems with the banks, and you were not on the list previously. You were never notified that, in fact, the Alexandria office, for instance, was in fact aggressively overdrafting, and that is how they accumulated so much in interest profits. And even though that figure stood out, the first indication you had was when you became aware of this particular situation in Kansas City?

Mr. Dippel. Until that time, I didn't dream—I didn't have a thought that there was any activity that was against company policy, let alone——

Mr. Hughes. Who set company policy?

Mr. Dippel. I don't understand.

Mr. Hughes. Who was it that set company policy? I mean, who was it that told you what company policy was?

Mr. Dippel. It would be different in different areas.

Mr. Hughes. Where did you take your lead from in company policy?

Mr. Dippel. In what area?

Mr. Hughes. In the area of interest profits.

Mr. Dippel. I did not know what company policy was.

Mr. Hughes. Well, didn't you have the responsibility of attempting to maximize interest income?

Mr. Dippel. Absolutely. I promoted it. I would use the analogy of my motivating the managers just like I would in a syndicate offering, a stock offering.

I do not—anything that E.F. Hutton does, in my mind, is good and proper. I never questioned, gee, is what Tom Morley doing right?

Mr. Hughes. Did you yourself ever encourage the branch managers to maximize interest profits by aggressively overdrafting?

Mr. Dippel. No.

Mr. Hughes. At no time?

Mr. Dippel. I only encouraged them to contact Tom Morley and our operations people and use whatever tools they had to offer.

Mr. Hughes. And what did you understand that to mean when you encouraged them to contact Tom Morley?

Mr. Dippel. I understood that to mean that he was the specialist and the expert in that area, and that he would instruct them. I wasn't thinking of the managers. Managers don't do cashiering. Managers are sales motivaters; that they would train their cashiers to do whatever.

Mr. Hughes. Did you ever learn that the chaining was taking place?

Mr. Dippel. I knew of no chains.

Mr. Hughes. You did not know of any instances where accounts were opened up at rural banks in particular to delay the clearance time?

Mr. Dippel. I did not recognize that particular scenario.

Mr. Hughes. At no time—you had no evidence of that?

Mr. Dippel. That is correct.

Mr. Hughes. I have one final memo I would like for you to look at from George Ball to John Latshaw, February 25, 1982.

Without objection, it will be made a part of the record.

I am informed that it was placed in the record previously. Make the witness aware of it and provide a copy of the February 25, 1982 memo from Ball to Latshaw.

Are you familiar with that particular memo?

Mr. **Dippel**. Yes. This is a monthly memo that George sent, the format.

Mr. **Hughes**. In essence, this pretty much tracks the other memo?

Mr. **Dippel**. Yes.

Mr. **Hughes**. It indicates the excellent offices, maximizing their interest profits, the ones that were not doing so well?

Mr. **Dippel**. Yes.

Mr. **Hughes**. It indicates in the context of the memo, "however, the example set by Alexandria, Baltimore, Louisville, Washington I and Washington II demonstrates that strong leadership and determination can overcome even the most adverse conditions. Please do everything possible to get your lagging branches to emulate them."

That was a typical Ball memo encouraging maximization of interest profits?

Mr. **Dippel**. Yes, sir.

Mr. **Hughes**. You know, what I find very difficult to understand is how you can have such an elaborate scheme involving so many branch offices and have so few people know about it. You have listened to the testimony today. The branch offices indicate that they took their lead and they were provided policy by the regional vice presidents, people like yourself, and headquarters, people like Tom Morley.

Mr. **Dippel**. Yes.

Mr. **Hughes**. The people at headquarters indicate they didn't know what was happening at the branch offices. When you talk to the branch managers, they don't know what was happening because somebody else at the operations desk was operating the cash management.

You heard that testimony?

Mr. **Dippel**. Yes, I did, sir.

Mr. **Hughes**. It doesn't sound like anybody knew what was going on, does it?

Would you agree that you could perpetrate such a scheme unless some people knew?

Mr. **Dippel**. I can't evaluate that.

Mr. **Hughes**. Do you think corporations can act without people?

Mr. **Dippel**. No.

Mr. **Hughes**. Can you handle that one?

Mr. **Dippel**. No. I can handle that one and I would answer that no, sir.

Mr. **Hughes**. Do you think a scheme this elaborate that reached 100 branches could possibly have existed without people at headquarters knowing about it?

Mr. **Dippel**. I can't evaluate that.

Mr. **Hughes**. Well——

Mr. **Dippel**. Do you want me to speculate or guess?

Mr. **Hughes**. No, no, not guess. You know the structure of the company, don't you? How can you be generating tens of millions of dollars in interest profit, representing a major share of the profit of this company, and not have people knowing the nature and extent of the scheme? Do you find that plausible?

Mr. **Dippel**. It certainly indicates a lack of controls.

Mr. **Hughes**. Do you think it is plausible? Do you find that plausible?

Mr. **Dippel**. That one area of the firm can be without——

Mr. **Hughes**. That you have tens of millions in interest profit being generated, that you can have literally dozens and dozens of chains, all kind of drawing down, creating banks in rural areas, an effort to maximize profits by using a zero balance account in a couple different locations in the country. You know it requires an elaborate scheme, you certainly understand enough about the scheme to know that it was an elaborate scheme.

Mr. **Dippel**. Well, it certainly——

Mr. **Hughes**. Do you find it plausible that that could occur without people at your level and at headquarters not knowing about it?

Mr. **Dippel**. It certainly is a strange and unusual story.

Mr. **Hughes**. Does the gentleman have any questions?

Mr. **McCollum**. I have no further questions. I do appreciate Mr. Dippel's time and testimony today.

Mr. **Dippel**. Thank you.

Mr. **Hughes**. Thank you very much, we appreciate your testimony, Mr. Dippel.

Mr. **Dippel**. Thank you.

Mr. **Hughes**. The final witness today is Mr. Perry Bacon. Mr. Bacon joined the E.F. Hutton Co. in January 1977. He was a branch office manager of one of the Washington, DC, offices of E.F. Hutton. From April 1980 to August 1982 he was simultaneously the branch manager for the Alexandria, VA, and Washington, DC, branch offices. Washington, DC. and Alexandria are both in E.F. Hutton's central region, as I understand it.

Mr. Bacon, on behalf of the Subcommittee on Crime we welcome you here today. Let the record indicate that pursuant to clause 2 of rule XI of the Rules of the House of Representatives, copies of the Rules of the Judiciary Committee, and of clause 2 of rule XI of the Rules of the House, have been made available to you and are now at the counsel table. Mr. Bacon, you have a right to have counsel assist you in the course of this morning's, or this afternoon's proceedings. Are you accompanied by counsel?

Mr. **Bacon**. Yes.

Mr. **Hughes**. I wonder if counsel will identify themselves.

Mr. **Tigue**. I am John K. Tigue, Jr., T-i-g-u-e.

Mr. **Hibey**. Good afternoon, Mr. Chairman. I am Gerald Hibey, H-i-b-e-y.

Mr. **Hughes**. Welcome. Thank you.

I will now place you under oath. Would you raise your right hand for the oath, Mr. Bacon. Do you solemnly swear or affirm that the testimony you are about to give to this committee is the truth, the whole truth and nothing but the truth, so help you God?

Mr. **Bacon**. I do.

Mr. **Hughes**. Please be seated.

Mr. Bacon, you have a statement which has been made available to the committee. It will be made a part of the record in full. You may proceed as you see fit. You may wish to summarize it. It is not a long statement. You may want to read it.

Mr. **Bacon**. Since it is quite brief, Mr. Chairman, I will read it, if that is all right.

Mr. **Hughes.** That is fine, sir.

Mr. **Bacon.** Thank you, Mr. Chairman.

TESTIMONY OF PERRY H. BACON, BRANCH MANAGER, ATLANTIC REGION, E.F. HUTTON

Mr. **Bacon.** My name is Perry Bacon. I have been the manager of one of E.F. Hutton's Washington, DC, branches from its opening in January 1977 to the present. Additionally, I was the manager of Hutton's Alexandria, VA, branch from its opening in April 1980 until August 1982.

Between the latter part of 1981 and early 1982, those branches utilized a procedure for increasing profits on the interest derived from our bank accounts. I understood Hutton's system for the utilization of funds was a mechanism that competed with the banks' practice of withholding availability of checks in order to have the free use of those funds for a period of time. These money mobilization principles were set forth and explained to me in various conversations, memoranda, and meetings. Furthermore, I was encouraged orally and in writing by my regional supervisor to be aggressive in applying these money mobilization principles.

I always understood that any negative balance that might have been caused by our drawdown practices would be covered by the company, and, therefore, I believed that our drawdowns were a logical implementation of the Hutton system as it was taught to me by our money mobilizers. For these reasons, it never occurred to me that what we were doing was wrong by any standard, to say nothing of the criminal law.

I wish to comment on a document, which I authorized, which has been the subject of media attention and comment. In April 1982, I wrote a memorandum out of anger, in response to what I considered an unwarranted attack on me by my associate. In that memorandum, I described the banking activities that I believed then were being practiced by the company. Whatever my use of the word "bogus" in that description, it is clear that I always knew any drawdown check would be covered.

In this memorandum, I pointed out that drawing down was part of a system the banks knew well and participated in themselves and cited, as an example, public reports of banks holding checks for a period of time before honoring them, and thereby enjoying the use of the funds interest free.

On the other hand, I specifically stated in the memorandum my belief that "our objective is not to steal money from the banks." In order to understand my intent in writing about the system, and my endorsement of a method that gave Hutton, rather than the banks, the benefit of the "float," one must consider that statement of the objective.

The entire context of this memorandum reflects my personal feelings at the time which, in turn, influenced my less than precise verbiage on issues of presenting overriding importance. It was never my intent, and I so expressed it, to cheat the banks.

And it bears repeating Bob Fomon's uncontradicted statement that these banking activities did not involve or in any way jeopardize client funds.

In conclusion, it is an understatement that I am chastened by this affair. The embarrassment my colleagues and I have experienced is great. While I remain steadfast in my belief that I never did anything illegal, I recognize the importance of all that has happened and subscribe, both personally and as an employee of E.F. Hutton, to all requirements of law and of company policy that seek both to establish lawful compliance as well as restore public confidence in our fine company.

Thank you.

Mr. HUGHES. Thank you very much, Mr. Bacon.

You have heard the compensation described here today. Were you basically on the same compensation system?

Mr. BACON. Yes.

Mr. HUGHES. Ten percent of the interest income generated by your office?

Mr. BACON. Yes.

Mr. HUGHES. You have sat through a lot of testimony today and I am sure you followed with great interest the testimony before this committee previously. Essentially, I would just summarize from Mr. Dippel, the thrust of the testimony, upper management and middle management suggest that it was branch managers like yourself that devised this; that you were off the reservation; this was not company policy; that in fact you were responsible for the aggressive overdrafting practices. What do you have to say to that?

Mr. BACON. I don't believe that is accurate.

Mr. HUGHES. You don't believe what I just related to you is accurate or you don't believe that——

Mr. BACON. I don't believe that that characterization of the branch manager role in this affair is an accurate or fair one.

Mr. HUGHES. Tell us who specifically told you to engage in aggressive overdrafting.

Mr. BACON. No one did.

Mr. HUGHES. Well, then whose idea was it?

Mr. BACON. I identified in my statement that I believed that our particular drawdown practices in our branch were the logical extension of the system, of the drawdown systems we were taught. As you have observed, we have seen a lot of memoranda today which cover the period of 1981, I believe, which encouraged branch managers in a variety of ways to believe that they could be aggressive in their pursuit of the drawdowns. I believe branch managers were encouraged to believe—as one of the memoranda we saw just recently said, don't go below the formula.

Mr. HUGHES. By whom?

Mr. BACON. By a combination of conversations and memoranda and branch managers' meetings. We had a branch managers' meeting in New York in the middle of June 1981. In our particular region, through a variety of conversations, we were advised that our region was either the lowest or among the lowest in interest profits in the firm, and we were encouraged to get them up.

Mr. HUGHES. When you say that you believed it was the logical extension, what were you trained, when you first went with the company, to do in the way of generating interest profits?

Mr. BACON. Nothing, sir. All that was done by the cashier.

Mr. HUGHES. Well, you had no knowledge of what——

Mr. BACON. Did I understand you to just say when I first joined the company?

Mr. HUGHES. Yes, when you first joined the company.

Mr. BACON. Yes, sir. No training at all. All the banking activities were handled by the cashier.

Mr. HUGHES. After you were with the company for a while you took on additional responsibilities.

Mr. BACON. No.

Mr. HUGHES. There came a time when you became actively involved——

Mr. BACON. Yes.

Mr. HUGHES [continuing]. In the money market policies of your branch?

Mr. BACON. Actively involved to the extent of becoming aware of what our interest profits were; not to the extent of working with the drawdowns.

Mr. HUGHES. You knew that the more interest profit you generated the more salary you would draw?

Mr BACON. Yes.

Mr. HUGHES. So you knew that if you had a successful money market policy in place that you would generate more remuneration for your services?

Mr. BACON. That is correct.

Mr. HUGHES. Who was it that decided that you would sever the relationship between deposits and drawdowns?

Mr. BACON. I don't understand the question.

Mr. HUGHES. Who was it that decided, was it you or somebody else that decided that there would be little relationship between customer deposits and drawdown on that particular account?

Mr. BACON. I am not certain that I agree with that statement.

Mr. HUGHES. Let me just tell you that in your branch operations there are entries—let me ask you another way.

Mr. BACON. Yes, sir.

Mr. HUGHES. How did you decide how much to draw down on a given day?

Mr. BACON. Is there a particular timeframe that your question is referencing?

Mr. HUGHES. Let's talk in terms of the timeframe 1980–82.

Mr. BACON. Between 1980 and June 1981 there were very little activities involving cash management whatsoever. Our branch followed the formula and did whatever the cashiers did. Beginning in the middle of 1981 when we were encouraged to become aggressive with our cash management practices.

What was the question?

Mr. HUGHES. The question is, how did you determine how much to drawdown?

Mr. BACON. We——

Mr. HUGHES. You asked me what timeframe. I said 1980 to 1982. And now you are telling me.

Mr. BACON. From 1980 to the middle of 1981 I have no answer to the question because I was not involved in it. Beginning in the middle of 1981, we developed our own formula that enhanced the firm's basic drawdown system.

Mr. HUGHES. Who determined that particular formula?

Mr. **Bacon**. I did.

Mr. **Hughes**. What was the formula?

Mr. **Bacon**. The formula was a system whereby we would begin to overdraft by small amounts and increase those drawdowns. If a bank objected and felt they were not getting proper use of the funds, we would stop doing it. In fact, in the most notable instance, that of Alexandria, as our drawdowns increased the bank would call me up and thank me for the increased deposits. They believed it was an entirely profitable relationship to them.

Mr. **Hughes**. Of course they didn't realize what was happening, did they?

Mr. **Bacon**. They were fully aware of where the deposits were coming from.

Mr. **Hughes**. You think the banks were fully aware?

Mr. **Bacon**. Yes, I do.

Mr. **Hughes**. Well, that is not what the banks are telling us.

Mr. **Bacon**. I believe that United Virginia Bank will agree with that.

Mr. **Hughes**. Let me just give you an example.

Were you making the decision as to the amount of drawdown in November 1981?

Mr. **Bacon**. Yes, sir.

Mr. **Hughes**. Looking at the entry of November 2, 1981, November 2, there is a deposit of $78,629. That represents customers' deposits that day?

Mr. **Bacon**. I don't know what you reference, sir.

Mr. **Hughes**. I wonder if the staff will make available the United Virginia Bank statement of E.F. Hutton, and I understand that was provided to you this morning.

Mr. **Tigue**. No, I don't believe so.

Mr. **Hughes**. Provide another copy.

Mr. **Tigue**. We were given a——

Mr. **Hughes**. We will provide another copy.

[The statement referred to follows:]

C-23-1103 E.F.HUTTON Alexandria, VA UNITED VIRGINIA BANK

DATE	CUSTOMER RECEIPTS	CHEM/UST UST	CHECK NO.	KCN 1020	WIRED	TOTAL RECEIPTS	DRAWDOWN TO: COMMERCE BANK	CHECK NO.	DM(CM)	CUSTOMER CHECKS	BOOK BALANCE
01-Nov-81						0.00					(9,848,458
02-Nov-81	70,629.46	9,782,800.00				9,853,429.46	9,953,400.00				(9,948,428.
03-Nov-81	177,391.17	9,776,000.00				9,953,391.17	9,870,600.00				(9,865,637
04-Nov-81	150,524.42	9,720,000.00				9,870,524.42	250,300.00				(245,613.
05-Nov-81	53,213.00					53,213.00	150,000.00				(342,400.
06-Nov-81	168,574.69	184,500.00				353,074.69	9,650,000.00				(9,639,325.
07-Nov-81						0.00					(9,639,325.
08-Nov-81						0.00					(9,639,325.
09-Nov-81	183,465.41	9,466,000.00				9,649,465.41	9,749,300.00				(9,739,360.
10-Nov-81	106,956.65	9,637,300.00				9,744,256.65	9,869,200.00		12.00		(9,864,315.
11-Nov-81						0.00					(9,864,315.
12-Nov-81	81,344.53	9,783,900.00				9,865,244.53	180,300.00				(179,371.
13-Nov-81	122,999.31	59,300.00				182,299.31	9,675,000.00				(9,672,071.
14-Nov-81						0.00					(9,672,071.
15-Nov-81						0.00					(9,672,071.
16-Nov-81	245,400.49	9,430,500.00				9,675,900.49	9,801,000.00				(9,797,091.
17-Nov-81	56,592.54	9,744,400.00				9,800,992.54	9,950,900.00				(9,946,998.
18-Nov-81	42,040.57	9,900,900.00				9,950,940.57	5,996,400.00				(5,992,458.
19-Nov-81	106,443.10	5,900,000.00				6,006,443.10	110,000.00				(96,015.
20-Nov-81	38,951.39	71,000.00				109,951.39	9,590,900.00		1,000.00		(9,577,963.
21-Nov-81						0.00					(9,577,963.
22-Nov-81						0.00					(9,577,963.
23-Nov-81	77,516.97	9,513,400.00				9,590,916.97	9,700,500.00				(9,687,546.
24-Nov-81	114,287.67	9,575,700.00				9,689,987.67	6,380,900.00				(6,378,458.
25-Nov-81	54,202.73	6,337,200.00				6,391,402.73	155,200.00				(142,256.
26-Nov-81						0.00					(142,256.
27-Nov-81	100,242.46	56,915.00	10940		300,000.00	457,157.46	9,873,600.00				(9,558,698.7
28-Nov-81						0.00					(9,558,698.7
29-Nov-81						0.00					(9,558,698.7
30-Nov-81	55,552.66	9,507,000.00				9,562,552.66	9,662,555.00				(9,658,781.1

C-20-1100 E.F.HUTTON Alexandria, VA UNITED VIRGINIA BANK

SUMMARY 1981:	Customer	Chem/UST	KCM (1020)	Wires	Total Deposits	Drawdown	DR(CR)	CUSTOMER CHECKS
January	2,309,223.47	1,080,500.00	743,500.00	0.00	4,133,223.47	4,109,721.97	1.50	23,500.00
February	1,032,223.04	1,667,300.00	173,400.00	0.00	2,872,923.04	3,670,225.00	1.00	0.00
March	2,456,621.01	6,894,054.64	1,244,100.00	0.00	10,594,775.65	11,423,600.00	(157.00)	0.00
April	3,263,067.33	15,449,700.00	0.00	0.00	18,712,767.33	17,767,500.00	103.00	12,653.52
May	2,573,517.12	8,798,700.00	10,000.00	1,100,000.00	12,482,217.12	13,822,090.00	5,443.75	11,000.00
June	2,912,850.02	18,408,900.00	0.00	321,891.50	21,643,641.52	22,682,100.00	5,614.02	0.00
July	2,512,772.49	47,168,600.00	0.00	0.00	49,681,372.49	53,799,004.11	5,071.00	0.00
August	1,882,564.37	59,667,600.00	0.00	0.00	61,550,164.37	62,973,500.00	10,021.00	0.00
September	1,861,744.81	90,444,100.00	0.00	0.00	92,305,844.81	84,833,405.00	89,460.57	0.00
October	3,122,040.71	95,967,032.00	0.00	0.00	99,089,072.71	108,575,683.00	94,879.41	0.00
November	2,006,409.22	128,454,815.00	0.00	300,000.00	130,761,224.22	130,570,455.00	1,012.00	0.00
December	7,544,363.61	119,753,130.00	0.00	0.00	127,297,493.61	127,369,420.00	22.52	0.00
Totals:	33,537,397.20	593,694,431.64	2,171,000.00	1,921,891.50	631,324,720.34	640,796,712.08	211,472.77	47,153.52

C-29-1103 E.F.HUTTON Alexandria, VA UNITED VIRGINIA BANK

DATE	CUSTOMER RECEIPTS	CHEM/UST UST	CHECK NO.	KCM 1020	WIRED	TOTAL RECEIPTS	DRAWDOWN TO: COMMERCE BANK	CHECK NO.	DM(CK)	CUSTOMER CHECKS	BOOK BALANCE
01-Nov-81						0.00					(9,840,458
02-Nov-81	70,629.46	9,782,800.00				9,853,429.46	9,953,400.00				(9,940,428.
03-Nov-81	177,391.17	9,776,000.00				9,953,391.17	9,870,600.00				(9,865,637.
04-Nov-81	159,524.42	9,720,000.00				9,878,524.42	250,300.00				(245,613.
05-Nov-81	53,213.00					53,213.00	150,000.00				(342,400.
06-Nov-81	168,574.69	184,500.00				353,074.69	9,650,000.00				(9,639,325.
07-Nov-81						0.00					(9,639,325.
08-Nov-81						0.00					(9,639,325.
09-Nov-81	183,463.41	9,466,000.00				9,649,463.41	9,749,300.00				(9,739,360.
10-Nov-81	106,956.65	9,637,300.00				9,744,256.65	9,869,200.00		12.00		(9,864,315.
11-Nov-81						0.00					(9,864,315.
12-Nov-81	81,344.53	9,783,900.00				9,865,244.53	100,300.00				(179,371.
13-Nov-81	122,999.31	59,300.00				182,299.31	9,675,000.00				(9,672,071.
14-Nov-81						0.00					(9,672,071.
15-Nov-81						0.00					(9,672,071.
16-Nov-81	245,400.49	9,430,500.00				9,675,900.49	9,801,000.00				(9,797,091.
17-Nov-81	56,592.54	9,744,400.00				9,800,992.54	9,950,300.00				(9,946,998.
18-Nov-81	42,040.57	9,908,900.00				9,950,940.57	5,996,400.00				(5,992,458.
19-Nov-81	106,443.10	5,980,000.00				6,086,443.10	110,000.00				(96,015.
20-Nov-81	38,951.39	71,000.00				109,951.39	9,590,900.00		1,000.00		(9,577,963.
21-Nov-81						0.00					(9,577,963.
22-Nov-81						0.00					(9,577,963.
23-Nov-81	77,516.97	9,513,400.00				9,590,916.97	9,700,500.00				(9,687,546.
24-Nov-81	114,287.67	9,575,700.00				9,689,987.67	6,380,900.00				(6,378,458.
25-Nov-81	54,202.73	6,337,200.00				6,391,402.73	155,200.00				(142,256.2
26-Nov-81						0.00					(142,256.2
27-Nov-81	100,242.46	56,915.00	10340		300,000.00	457,157.46	9,873,600.00				(9,558,698.7
28-Nov-81						0.00					(9,558,698.7
29-Nov-81						0.00					(9,558,698.7
30-Nov-81	55,532.66	9,507,000.00				9,562,532.66	9,662,555.00				(9,658,781.1

Mr. HUGHES. Why don't we do this: Our vote is in progress. While you are looking at that, rather than waste time at this point, while we are trying to get it to you, let's stand in recess for 10 minutes while we catch that vote. And we will be right back.

The subcommittee is in recess.

[Recess.]

Mr. HUGHES. The subcommittee will come to order.

Mr. Bacon, have you had a chance to review this document that is a matter of record, which appears to be a summary, 1981 summary of the E.F. Hutton Alexandria, VA, account with the United Virginia Bank.

Do you recognize it as such?

Mr. BACON. Yes, sir.

Mr. HUGHES. OK.

Mr. BACON. And I have had a chance to review it. I can't tell you precisely on the dates circled that—that was your question, November 2? The drawdown versus the total receipts, you would need to back this up 2 to 3 months and see the series of deposits that we did to work up to that.

Moreover, I certainly authorized the cashier to do whatever was done in the branch. I wouldn't know on any individual day the manner in which she derived the calculation.

Mr. HUGHES. You say you wouldn't know how she arrived at the individual calculation? I assume from that that you did not participate in that decision?

Mr. BACON. No, sir; I just said I would certainly have authorized the decision, would have known the number might have been that high, but I never worked with the drawdown sheets to determine the actual calculation.

Mr. HUGHES. At that time, was there any relationship whatsoever between the amount of moneys that had been deposited by customers and the amount you were drawing down?

Mr. BACON. It would appear from this sheet that there was not.

Mr. HUGHES. When was the system changed, that is, the formula changed, where you delinked, if there was a time, delinked what customers deposited with you representing transactions with E.F. Hutton, and the drawdowns that had no relationship with deposits?

Mr. BACON. I don't believe we did it in the manner in which you suggest.

I believe that we consistently increased our drawdowns over a very lengthy period of time, and as I mentioned some minutes ago, in the instance of United Virginia Bank, they were aware where the deposit checks were coming from.

I spoke with the branch manager; he believed the account was a profitable one for them, and I had no reason to believe he was incorrect in that assumption.

Mr. HUGHES. You know that is not the case today, don't you, because obviously there is a claim directed at E.F. Hutton by United Virginia Bank, is there not?

Mr. BACON. I am not aware of any specific claim. I know we received a letter from them that I have not seen.

I am aware that that letter identifies that, No. 1, the first they heard of a problem was when they read about it in the newspaper following this subcommittee's first hearing.

No. 2, they had theretofore previously believed the relationship was a profitable one to them.

No. 3, on their first examination of that account, they continued to believe the relationship was profitable to them.

Mr. HUGHES. That is because they didn't know what was going on, did they?

Mr. BACON. I dispute that, Congressman, in all due respect.

Mr. HUGHES. With all due respect, we have talked with the banks.

Mr. BACON. OK.

Mr. HUGHES. And the banks were not aware of these practices. They were aware of the fact that you were depositing large sums of money which showed up in their accounts as deposits. They did not realize the vast majority of those were uncollected funds and that that was built up over a period of time to where, with deposits in the tens of thousands, you have drawdowns of $8 and $9 million on a given day.

Mr. BACON. Yes, sir; I don't dispute that.

My contention was that at that time we participated in this, the bank believed the relationship was profitable, and I have no reason to disbelieve them.

Mr. HUGHES. I am sure they probably did, because they saw a lot of activity, but are you suggesting that they knew that you were drawing down on uncollected funds aggressively?

Mr. BACON. Sir, I am suggesting that I didn't know that the relationship was not profitable to them.

Mr. HUGHES. Did you ever tell them what you were doing?

Mr. BACON. How would you define "telling them what we were doing"? I had lunch with the branch manager of that bank on several occasions during this process.

Mr. HUGHES. Did you ever tell him that you were, in fact, you tried to maximize interest profits drawing down millions of dollars with deposits that were just a fractional part of that.

Mr. BACON. No, sir.

Mr. HUGHES. It is not hard to understand that they would not be happy with that arrangement if they knew it, is it? That is not hard to understand.

Mr. BACON. I don't know how to comment on that. I mean, I——

Mr. HUGHES. Well, what formula did your cashier use, if any, in determining how much to draw down?

Mr. BACON. I do not know the specific that she used. I am aware that over, as I have already stated, over an extended period of time we built up to larger and larger drawdowns.

Mr. HUGHES. What did you tell her, though? What did you instruct her? You were her boss, were you not?

Mr. BACON. I instructed her that it was our objective to maximize our interest profits.

Mr. HUGHES. Did you tell her how to do that?

Mr. BACON. In terms of how to do the drawdown sheets? No, sir.

Mr. HUGHES. How to maximize the interest profits.

Mr. BACON. I told her that by increasing the amount of our drawdowns, I believed we would increase our interest profits.

Mr. HUGHES. Were there ever times when you told her to increase it by additional amounts?

Mr. BACON. To increase the total amount of the drawdowns, yes, sir.

Mr. HUGHES. And on how many occasions over that period of time?

Mr. BACON. I don't remember, sir.

Mr. HUGHES. Would it be safe to say that you would periodically tell her to draw down more than she had drawn down?

Mr. BACON. I don't remember.

Mr. HUGHES. You don't have any independent recollection?

Mr. BACON. The bank records during that time would certainly seem to support that suggestion of yours.

Mr. HUGHES. Did you pay any attention to drawdown sheets during that period of time?

Mr. BACON. No.

Mr. HUGHES. So they were just discarded at that point?

Mr. BACON. I wouldn't have looked at them. As I said, when I joined—from the time I joined the firm in 1977 to the present, I didn't pay attention to drawdown sheets.

From the point in time you originally asked your question, from 1980 until the middle of 1981, I barely paid attention to interest profits whatsoever.

Mr. HUGHES. Was the cashier working on a 10-percent bonus basis, too?

Mr. BACON. No, sir.

Mr. HUGHES. Just you?

Mr. BACON. That is correct.

Mr. HUGHES. So she didn't really benefit from maximizing interest profits?

Mr. BACON. No.

Mr. HUGHES. You did.

Mr. BACON. That is correct.

Mr. HUGHES. So it was in your interest to make sure that that policy was carried out?

Mr. BACON. As well as in the corporation's.

Mr. HUGHES. Did you hear Mr. Dippel suggest that he never advised you to engage in aggressive overdrafting; in fact, he didn't know you were doing that? Did you hear him say that?

Mr. BACON. I didn't hear him say it that way, no.

Mr. HUGHES. I know I didn't say it—I am characterizing his testimony.

What he said was you were off the reservation. You were on your own. He said that he didn't know that that was taking place.

Mr. BACON. Excuse me, Congressman, in all due respect, I didn't hear Mr. Dippel say that.

Mr. HUGHES. You didn't hear?

Mr. BACON. That I was off the reservation, on my own, no, sir, I didn't.

Mr. HUGHES. I characterized it that way.

What he said, in essence, was that he didn't know that aggressive overdrafting was taking place. And he didn't encourage aggressive overdrafting.

Isn't that what he said?

Mr. BACON. I can't speak for what was in Mr. Dippel's mind.

Mr. HUGHES. No; I didn't ask you to do that.

Mr. **Bacon**. Mr. Dippel was aware——

Mr. **Hughes**. Did you——

Mr. **Bacon**. Excuse me, go ahead.

Mr. **Hughes**. Isn't that what Mr. Dippel testified to? He testified that he didn't know that aggressive overdrafting was taking place.

Mr. **Bacon**. And my response to that was I can't jump inside of Ernie's mind and figure out what was aggressive to him and what wasn't.

Mr. Dippel was aware we were drawing down $9 million on some days.

Mr. **Hughes**. Now, he led the committee to believe he didn't know that.

Mr. **Bacon**. I didn't hear him say that, sir. I didn't hear anybody ask him if he was aware of the amount of money we were drawing down.

Mr. **Hughes**. I asked Mr. Dippel—wasn't he on notice that aggressive overdrafting was taking place because he sent some assessments out which showed that you had something like 70.8 percent of the gross profits in interest income.

I asked him: Didn't that suggest to you, Mr. Dippel, that there was something unusual about this office? How do you account for the fact that that much was being generated? Wasn't that the question I asked him?

Mr. **Bacon**. If I am not mistaken, his response, which he first conveyed to me 90 days ago, is he picked up the phone and called Tom Morely and asked, how can that branch make that much in interest profits?

Mr. **Hughes**. Yes; and he said, "I didn't encourage aggressive overdrafting."

Mr. **Bacon**. At the beginning of the testimony he stated he did encourage us to get our interest profits up, and as our interest profits improved, he further stated he acquired from Tom Morely how we were able to do so.

Mr. **Hughes**. Let me ask you, did Mr. Dippel tell you to maximize your interest profits by aggressively overdrafting the account?

Mr. **Bacon**. I don't recall if he used those specific words. I do recall discussing our interest profits with Ernie.

Mr. **Hughes**. What did he tell you was the policy of the company?

Mr. **Bacon**. I don't recall specific discussions of policy whatsoever.

Mr. **Hughes**. Well——

Mr. **Bacon**. We discussed——

Mr. **Hughes**. You indicated it was company policy to engage in aggressive overdrafting. In fact, that is part of the substance of the Barlove-Bacon correspondence, that it was company policy.

Mr. **Bacon**. Yes, sir.

Mr. **Hughes**. You were just carrying out policy.

Mr. **Bacon**. I believe that to be the case.

Mr. **Hughes**. Who in policy making beside Mr. Dippel did you talk to about it?

Mr. **Bacon**. About our specific overdrafting?

Mr. **Hughes**. Mr. Bacon—about aggressive overdrafting.

Mr. BACON. I would have had conversations in 1981 with several branch managers.

Mr. HUGHES. Give me some names. Who specifically did you talk with in policymaking positions in the company that advised you that you should be maximizing your interest profits by aggressive overdrafting?

Mr. BACON. As you phrase the question, sir, I don't believe I can say there was anything. In a policymaking position, I certainly discussed with Mr. Tom Morley before we began what you term "our aggressive overdrafting."

Mr. HUGHES. Do you quibble with that terminology, aggressive overdrafting?

Mr. BACON. No; what I was quibbling with was your question to me who did I discuss this with in a policymaking position in New York on an aggressive overdrafting.

Mr. HUGHES. No; I said in a policy making position.

You have indicated that it was company policy. You didn't design this. You just carried out what was company policy.

Aggressive overdrafting was company policy. Mr. Dippel would lead us to believe in his testimony that he didn't know anything about the aggressive overdrafting.

Now, my question to you is if it were company policy and you didn't create the policy, who did? Specifically who did tell you that that was company policy?

Mr. BACON. Are you referring to the firm's drawdown system or the particular practices to which the Alexandria, in which the Alexandria branch participated?

Mr. HUGHES. I am talking about the practices you followed as branch manager of two branches engaging in aggressive overdrafting in maximizing interest profits.

Mr. BACON. I discussed those policies that we carried out in our branches with two officers of the firm who were senior to me.

Mr. HUGHES. And who are they?

Mr. BACON. Ernie Dippel, and a man named Richie Genin.

Mr. HUGHES. How do you spell Richie Genin?

Mr. BACON. G-e-n-i-n.

Mr. HUGHES. What is his title?

Mr. BACON. I don't know precisely what his title is.

Mr. HUGHES. Was he in headquarters?

Mr. BACON. Yes, sir.

Mr. HUGHES. Was he—would you characterize him as senior management?

Mr. BACON. That is not my call to make. He was an officer in New York.

Mr. HUGHES. Was this a formal memorandum, was it conversation, was it a regional or branch meeting? How did the conversation take place?

Mr. BACON. It was a telephone conversation. He called me in the latter part of 1981 or beginning of 1982 to inquire as to how we were making so much money in interest profits in our Alexandria branch. I explained to him what we were doing.

Mr. HUGHES. And what was his response?

Mr. BACON. There was no response. I asked him if we were doing anything wrong insofar as pertains to the banks, but it never occurred to us that we were doing anything wrong as pertained to the banks, and if we were doing anything wrong with respect to the firm.

For this reason, Ernie and I discussed on one or two occasions that given the possibility of the amount of interest profits that our branch was going to become credited, was it possible there was a glitch in the Hutton system and that these were really elusive paper profits that blocked somewhere else or perhaps didn't really exist, because could the firm really be getting the use of the money that quickly that our branch was properly being credited with.

So at the conclusion of my conversation with Mr. Genin, I specifically asked him if it was all right insofar as it pertained to E.F. Hutton, what would have been his interpretation of that, and he said it was.

I picked up the phone, called Ernie Dippel, related the conversation to him and he told me if he heard anything further on it, he would get back to me.

Mr. HUGHES. Mr. Bacon, that was after you implemented these practices, was it not?

Mr. BACON. Yes, sir.

Mr. HUGHES. Did you understand it to be company policy previous to that conversation?

Mr. BACON. Did I understand what to be company policy, Congressman?

Mr. HUGHES. Aggressive overdrafting, what you described to Richie Genin you had already engaged in, in those practices——

Mr. BACON. Yes, sir.

Mr. HUGHES [continuing]. When you had the conversation with Mr. Genin.

Mr. BACON. I am sorry, yes, I did believe it to be company policy.

Mr. HUGHES. How did you come to understand it was company policy prior to that conversation?

Mr. BACON. By dint of the volumes of memoranda and meetings and oral communications that were transferring themselves around the firm, to wit, the fabulous interest successes that some branches were enjoying and the conclusion I drew was that that was being done by aggressive overdrafting practices.

Mr. HUGHES. In other words, you saw a number of the memoranda, some of which were described today or memoranda like that, which suggested that "We should be maximizing interest profit," that the name of the game is to take avantage of the high interest rates, that we should be talking to Tom Morley about management practices.

Is that what you are referring to?

Mr. BACON. Yes, sir, it is. If I may, if it is appropriate, I would like to quote from the complaint, the E.F. Hutton complaint and settlement with the Government that addresses the specific questions you are asking me.

Mr. HUGHES. Sure.

Mr. BACON. This is on page 30 of the civil complaint alleged by the Government and admitted to by E.F. Hutton:

> No. 18, defendant Hutton Company encouraged branch managers to be more aggressive and creative in overdrafting of their bank depository bank accounts. Stimulated by the above and realizing that they could not employ the formulation, the

strict formulas, of Hutton Company's drawdown sheet either aggressively or creatively, certain Hutton branch managers exceeded the basic drawdown formula.

Mr. HUGHES. I understand that that is one of the provisions in the plea but the fact of the matter is, that the testimony to date from management has been that these were not policies, and these were practices carried out by branches without corporate headquarters' sanction and in fact, you were doing things that did not represent policy.

Let me take you back to once again, aside from the memoranda, the correspondence, were there any other indications that this was corporate policy and that you were to follow the policy?

Mr. BACON. Well——

Mr. HUGHES. Were there any manuals prepared, training manuals, were there any materials passed out at training sessions that described aggressive overdrafting?

Mr. BACON. Not specifically, no, sir.

Mr. HUGHES. What do you mean by "bogus funds?" You make an effort to explain that in your statement, and I really don't understand your explanation.

Mr. BACON. That they might not be real; that I believed we were encouraged to anticipate receipts in a variety of ways, some of which have been discussed earlier today, another one of which is wire funds.

To the extent that a customer has made a terribly large purchase and has to wire in $1, $2, $3, $4 million, those are identified as immediate good funds to the branch.

We are encouraged to anticipate those.

The answer to your question is, you get in the habit of consistently anticipating receipts because you believe you are encouraged to do so, you develop a pattern of anticipating receipts which may not in fact really exist, but the pattern continues precisely as you identified in the illustration of the United Virginia Bank.

Mr. HUGHES. But don't you really mean ficticious funds, isn't that what you are talking about, fictitious funds?

Mr. BACON. Well——

Mr. HUGHES. You never anticipated having deposits except from the zero balance account to cover a $7 or $8 million check. You didn't have that kind of activity, did you?

Mr. BACON. I am sorry, the question?

Mr. HUGHES. You didn't have $7 or $8 million in activity on a daily basis in your office, did you?

Mr. BACON. No, we didn't.

Mr. HUGHES. So you had no reason to expect $7 or $8 million in income coming in from customers on any given day.

Mr. BACON. Not on any given day, no.

Mr. HUGHES. Isn't that what you meant by fictitious funds, what you had under way was a system that you built up over a period of time which is tantamount to kiting checks.

Mr. BACON. With all due respect, Congressman, I completely disagree with that.

Mr. HUGHES. You don't think that there is a parallel between covering the checks by drawing down on other accounts and what I would do if I were to write a check on a bank with uncollected funds, have another account cover that, and then in a couple days write another check on another account and cover that—you don't think that that is a kiting practice?

Mr. BACON. I don't find—I find the analogy a sequitur. I believe if we had ample funds, and we always had ample funds, to cover drawdowns, then we were not doing——

Mr. HUGHES. I can say the same thing, that I have ample funds, I have real estate and I have bonds I could liquidate. I could say to the bank, I could always cover that, I have the means to cover it. What is the difference?

Mr. BACON. To me, the difference is we had liquid funds at all times.

Mr. HUGHES. The difference is I am an individual and you are a corporation, isn't that the difference?

Mr. BACON. No, sir.

The difference is we had liquid funds at all times. I had no idea they were zero balance accounts, for all I knew. When we were doing this, what I did know and believed was that we were——

Mr. HUGHES. Do you think it would be a defense? If you engaged in a check kiting scheme with three accounts, you as an individual, and you wrote checks and then began to cover it on other checks that just kept the scheme going using the bank's money, do you think it would be a defense to an indictment for fraud, that you had liquid funds to cover the checks at any given moment?

Mr. BACON. I don't believe——

Mr. HUGHES. Do you think it would be a defense to a criminal indictment?

Mr. BACON. I don't believe that question pertains to what we were doing.

Mr. HUGHES. Well, you basically had a fictitious float. You had millions of dollars that had no relationship to the amount of customers' deposits. You were in effect acquiring bank loans in millions of dollars, using their money basically, and drawing down whatever was necessary on a given day to cover so that at the end of the day, the bank's ledger showed zero balance or a positive balance.

Isn't that what you were doing?

Mr. BACON. Well, sir, Mr. Chairman, what you asked is if I thought that I went through the exercise with the three separate checking accounts, if that would be wrong. And clearly in the illustration as you outline it, I believe it would be.

As we were implementing practices in our branch, it never occurred to me that there was anything wrong with it for the reasons I have suggested a couple times, and that is that I believed it was in compliance with company policy, moreover we could always cover any check.

Mr. HUGHES. Are you telling us you can honestly say there was never a time when it occurred to you that there is a parallel to kiting of checks, from what you were doing?

Mr. BACON. Absolutely not.

Mr. HUGHES. I find that amazing.

Mr. Bacon, thank you very much. We appreciate your testimony.

That concludes the testimony for today's hearing, and the subcommittee stands adjourned.

Is Mr. Dippel in the room? I want to recall Mr. Dippel if he is here.

He is not.

Thank you.

[Whereupon, at 5:47 p.m., the subcommittee was adjourned.]